

# The Scope and Activities of 501(c)(3) Supporting Organizations

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## SUMMARY OF FINDINGS

Supporting organizations provide a broad array of services, including grants and other financial benefits, to the organizations they support. This study found that nearly 92 percent of the large supporting organizations with no apparent grants in our sample did, in fact, provide significant financial services and benefits to their supported organizations. Complex business and legal reasons similar to those found in the for-profit world appear to lie behind the activities of most of these organizations.

## OVERVIEW

In section 509(a)(3) of the Internal Revenue Code, Congress established a category of public charities commonly referred to as “supporting organizations” that are operated “exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more [public charities].” The implementing regulations written by the Treasury Department are extensive. They include numerous definitions and examples and span more than eight pages of small type in a popular version of federal tax regulations. (See I.R.C. § 1.509(a)-4 in RIA Federal Tax Regulations.) The law and its corresponding regulations give broad latitude to the types of support that such organizations may provide to their supported organizations.

Supporting organizations are grouped by statute into three types, conveniently called Types I, II, and III. Types I and II are closely controlled by their supported organization or organizations. Type I supporting organizations are “operated, supervised or controlled *by*” their “parent” supported organizations. Typically, the board of the supported organization controls the board of the supporting organization. Type II supporting organizations are “supervised or controlled in connection *with*” their supported organization. They stand in a “sibling” relationship to their supported organization. To take a simplified example, the organizations were both created by the same philanthropist and board members on one organization sit on the other’s as well. Type III organizations are “operated in connection with” their supported organizations. Thus, there is no

requirement for formal control by their supported organizations. It is these Type III organizations that have been the object of most concern to policymakers and regulators.<sup>1</sup>

The Application for Recognition of Exemption (IRS Form 1023) that new public charities must complete requires that supporting organizations identify their type. Unfortunately, the IRS does not include type in its databases so there is no way, short of sampling the original Form 1023s, to know how many organizations of each type exist.

	Number		Total revenue		Total assets		Net assets	
Supporting orgs	30,566	10.6%	\$74,337	7.5%	\$301,220	16.8%	\$191,604	17.6%
Other public charities	258,717	89.4%	919,264	92.5%	1,490,178	83.2%	894,145	82.4%
Total	289,283	100.0%	993,601	100.0%	1,791,398	100.0%	1,085,749	100.0%

*Source:* National Center for Charitable Statistics Core Public Charity File, Fiscal Year circa 2003.  
*Note:* Supporting organizations include all organizations that identified themselves as supporting organizations in either their initial IRS Form 1023 application for exemption or on their most recent annual IRS Form 990.

Table 1 shows that nearly 11 percent of all 501(c)(3) public charities—more than 30,000 in all—identified themselves as supporting organizations on either their IRS Form 1023 (the initial application for exemption) or on their most recent annual IRS Form 990s. These organizations account only 7.5 percent of public charity revenues but a significantly larger percentage of public charities’ total assets (16.8%) and net assets (17.6%).

	Number		Total revenue		Total assets		Net assets	
Arts, culture, and humanities	1,441	4.7%	\$1,272	1.7%	\$7,110	2.4%	\$6,184	3.2%
Education	8,077	26.4%	11,848	15.9%	52,679	17.5%	38,699	20.2%
Environment	497	1.6%	573	0.8%	3,185	1.1%	2,126	1.1%
Health	5,769	18.9%	41,206	55.4%	126,582	42.0%	64,861	33.9%
Human services	5,218	17.1%	7,334	9.9%	23,495	7.8%	13,800	7.2%
Other	9,564	31.3%	12,103	16.3%	88,170	29.2%	65,935	34.4%
Total	30,566	100.0%	74,337	100.0%	301,220	100.0%	191,604	100.0%

*Source:* National Center for Charitable Statistics Core Public Charity File, Fiscal Year circa 2003.  
*Note:* Supporting organizations include all organizations that identified themselves as supporting organizations in either their initial IRS Form 1023 application for exemption or on their most recent annual IRS Form 990.

Table 2 shows that most supporting organizations are found in education, health, and human services sectors. Supporting organizations are especially common in education and health. Education has the largest number of supporting organizations with over 26 percent of total

<sup>1</sup> See, for example, U.S. Senate Finance Committee, Staff Discussion Draft on Charities and Charitable Giving (2004), p.2. <http://www.finance.senate.gov/hearings/testimony/2004test/062204stfdis.pdf>.

organizations and 16 percent of the revenues. In terms of revenues and assets, however, supporting organizations in the health field are the largest single category. These organizations, 19 percent of the total, account for 55.4 percent of total revenues and control 42 percent of total assets of all supporting organizations.

	Number		Total revenue		Total assets		Net assets	
Less than \$1 million	18,545	60.6%	\$4,825	6.5%	\$4,656	1.6%	\$3,596	1.9%
\$1 mil. to \$10 mil.	8,919	29.2%	12,209	16.4%	29,805	9.9%	23,443	12.2%
\$10 mil. to \$25 mil.	1,582	5.2%	8,712	11.7%	24,711	8.2%	17,735	9.3%
\$25 mil. to \$50 mil.	662	2.2%	6,211	8.4%	23,272	7.7%	16,921	8.8%
\$50 mil. to \$100 mil.	429	1.4%	8,371	11.3%	30,085	10.0%	19,534	10.2%
\$100 mil. to \$500 mil.	344	1.1%	18,063	24.3%	68,105	22.6%	43,803	22.9%
\$500 mil. or more	85	0.3%	15,946	21.5%	120,586	40.0%	66,572	34.7%
Total	30,566	100.0%	74,337	100.0%	301,220	100.0%	191,604	100.0%

*Source:* National Center for Charitable Statistics Core Public Charity File, Fiscal Year circa 2003.  
*Note:* Supporting organizations include all organizations that identified themselves as supporting organizations in either their initial IRS Form 1023 application for exemption or on their most recent annual IRS Form 990.

Over 60 percent of supporting organizations are relatively small with less than \$1,000,000 in assets. They generate only 6.5 percent of total revenues and control less than two percent of the total and net assets of supporting organizations. (Table 3) At the other end of the spectrum, organizations with more than \$100 million in total assets—the two largest categories—account for only 1.4 percent of the organizations but receive almost 46 percent of revenues and control 62.6 percent of the total assets and 57.6 percent of the net assets.

## **ANALYSIS OF THE LARGEST SUPPORTING ORGANIZATIONS**

There is a misconception that supporting organizations are solely grantmaking organizations that raise contributions from the general public or other sources and then make grants to their designated supported organizations.<sup>2</sup> An examination of the IRS Forms 990 for the largest supporting organizations, the 389 organizations reporting more than \$50 million in total assets in FY 2001,<sup>3</sup> shows that 25 percent reported no grants on their IRS Forms 990—or at least not in the locations that most people would expect. (Congressional Research Service, Testimony of Jane Gravelle before the Senate Finance Committee, April 5, 2005) This statistic has been

<sup>2</sup> The governing instruments of all supporting organizations must identify their “supported organizations” by name, or, in some cases, by class or purpose (such as all colleges or universities in a particular city).

<sup>3</sup> Supporting organizations that reported program service revenue of more than \$1,000 were excluded.

compared to private foundation payout rates to suggest that the supporting organizations are failing to provide justifiable levels of support to their supported organizations.

In order to assess these conclusions, the National Center for Charitable Statistics (NCCS) conducted a detailed analysis of a random sample of 36 supporting organizations drawn from the same group of organizations that the Congressional Research Service identified as having no grants. All of these organizations had total assets of more than \$50 million, no “payout” for FY 2001 reported under “payments to affiliates” (line 16 of the Form 990), “grants and allocations” (line 22), “specific assistance to individuals” (line 23), or “benefits paid to or for members” (line 24).<sup>4</sup> NCCS reviewed all schedules and attachments of these organizations’ Form 990s spanning as many as five years to ascertain if “support” could be found in either other parts of the form or in other years. This multiyear analysis is consistent with the method for calculating private foundation payout rates, which permits foundations to carry over excess payments and apply them to payout calculations over a five-year period. Thus, to use a simple example, a private foundation that paid out 25 percent of its assets in FY 2000 but none in the following four years could still meet its 5 percent payout requirement.

We did not have access to the Form 1023s of the organizations in our sample and cannot determine what proportion of these organizations were Type I or II organizations, and thus controlled by or with their supported organizations. However, a careful review of the organizations’ purposes, programs and finances from their annual IRS Form 990s lead us to believe that 32 of the 36 organizations (89 percent) in our sample are closely tied to specific supported organizations.<sup>5</sup> Their supported organizations would appear to have strong incentives to control them, although we cannot determine whether they were established as Type I, II, or III organizations.

The organizations in the sample engage in a mix of grantmaking and non-grantmaking activities (hereafter referred to as “operating activities”):

- Grantmaking is a major activity for 44 percent of the sample of organizations, although this activity was not necessarily reported on parts of the Form 990 associated with grantmaking. (An additional 11 percent appear to give grants as a minor activity.)
- Fully 78 percent of the organizations also had operating activities.

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<sup>4</sup> Like the Congressional Research Service list, this sample was limited to organizations with program service revenues of less than \$1,000 to ensure that the sample excluded organizations with diverse operating activities and sources of earned income that may have been misidentified as supporting organizations.

<sup>5</sup> These supporting organizations either showed clear evidence of control by supported organizations or indications of a direct formal relationship, such as providing financial or operational support integral to the operations of the supported organizations, or receiving staffing and substantial subsidies from the supported organizations.

- Thirty-three percent of organizations combine both grantmaking and operating support activities.
- Only 3 of the 36 (8%) reported support at levels low enough to call in question their charitable purpose, and one of the three appeared to be closely linked to its supported organization, typical of Type I or II relationships in which control of the supporting organization is unlikely to be problematic.

The small sample size—36 organizations— of this exploratory study means that the statistics presented here should be understood to be approximations. This sample represents more than one-third of the large supporting organizations reporting no grants on lines 16, 22, 23 or 24 of the Form 990. Using standard statistical tests, we can say with a very high degree of certainty that somewhere between 28 and 60 percent (44% +/- 16%) of the large organizations identified by the Congressional Research Service as making no grants, did in fact make substantial grants or financial transfers. All tables should be interpreted with this caveat in mind.

There is some concern that supporting organizations are established at the behest of donors primarily to sidestep private foundation payout requirements. However, there are also more benign structural and operational explanations. Supporting organizations can be used to help shield the assets of the supported organization from liability. Sometimes a nonprofit hospital may establish a separate fundraising support organization that conducts capital campaigns or manages endowments. This permits major donors to exercise leadership at a board level in determining investment policies and fundraising strategies while keeping the leadership of the operating hospital separate. This arrangement seems like a reasonable approach to taking advantage of the strengths of major donors while minimizing their lack of expertise in, say, hospital management. In the hospital industry, supporting organizations may have been established as part of the widespread practice of corporate restructuring that occurred in the late 1970s and 1980s.<sup>6</sup>

## **THE MANY ACTIVITIES OF SUPPORTING ORGANIZATIONS**

Non-grantmaking purposes include a wide range of activities. Table 4 shows the number of organizations engaged in each type of activity we uncovered in our analyses. Many supporting organizations engage in multiple activities.

Leading the list of specific operating activities is the pooling and managing of investments or endowments for supported organizations. Seventy-two percent of the supporting organizations provided this service to their supported organizations. From a management perspective, there are

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<sup>6</sup> See Bradford H. Gray, *The Profit Motive and Patient Care: The Changing Accountability of Doctors and Hospitals* (1991), pp.80–88.

likely to be efficiencies in pooling investment assets and managing them centrally when the assets from more than one supported organization are pooled together.

Another major area of activity is real estate. Nearly 42 percent of the organizations held real estate for one or more supported organizations. More than one-quarter (28%) provided rental property management or facilities management services for their supported organizations. Thirty percent provided in-kind support by giving their supported organizations exclusive use of property or facilities at little or no charge.

Just as with the management of investments, there may be sound business reasons for a supported organization to use a supporting organization for its real estate activities. For example, sometimes a supported organization will establish a supporting organization to hold environmentally sensitive land and buildings. The supporting organization often carries a mortgage to purchase the property, so the effects of this arrangement include removing debt from the balance sheet of the supported organization. The supporting organization would have a source of rental income from which it could service long-term debt or lease obligations and possibly provide an infusion of cash to the supported organization.

Nearly 60 percent of the organizations reported employee and office-related expenses. This is one possible indication, albeit not definitive, that the supporting organization plays a role that extends beyond asset holding.

<b>Table 4: Activities of Supporting Organizations (N=36)</b>		
	Number	Percent
Serves parent, holding, or umbrella role(s) for supported organizations	8	22%
Serves clearinghouse or “banking” role for inter-supported organization transactions	9	25%
Subsidiary of supported organization(s) for possible tax, legal, financial, or risk management purposes	6	17%
Provides pass-through of grants or other temporarily restricted funds to supported organization(s)	11	31%
Pools and manages investments and endowments for supported organization(s)	26	72%
Combines real estate holdings for supported organization(s) (does not include property management)	15	42%
Combines rental property and/or facilities management for supported organization(s)	10	28%
Combines debt issuance for supported organization(s) [issues bonds on behalf of supported organization(s)]	8	22%
Combines revenues, expenses, or net income of multiple supported organizations	2	6%
Combines or provides overall strategic management and/or mission alignment	6	17%
Combines marketing, purchasing, or other services (does not include property management)	1	3%
In-Kind Support: Provides property and/or facilities for exclusive use by supported organization(s) at little or no charge	11	31%
In-Kind Support: Provides services for or on behalf of supported organization(s) at little or no charge	6	17%
Fundraising Support: Annual or operating	12	33%
Fundraising Support: Capital or endowment campaign	11	31%
Fundraising Support: Special events or activities	9	25%
Fundraising Support: Donor recognition, awards, grants, other, or unspecified	10	28%
Pays employee- and office-related expenses	21	58%

*Source:* Analysis of IRS Form 990 returns spanning 1998–2004 for 36 supporting organizations reporting zero in FY 2001 for lines 16, 22, 23, and 24; having total assets more than \$50 million; and having program service revenue of less than \$1,000.

## IDENTIFYING SUPPORT ON THE FORM 990

Careful scrutiny of the IRS Form 990 is required to identify the many ways that supporting organizations are providing services or funds to their supported organizations. The organization’s primary purpose and list of “program service achievements,” both of which are found in Part III of the Form 990, provide the starting point for understanding where an organization’s support is

likely to be found. Services benefiting supported organizations can be found throughout the statement of functional expenses as program service expenses, as management and general expenses, or as fundraising expenses. Direct transfer to supported organizations—including grants, payments, and loans—can be found on at least 10 different lines on the Form 990:

1. Rental expenses paid to supported organizations (line 6b)
2. Payments to affiliates (line 16)
3. Other changes in net assets (line 20)
4. Grants and allocations (line 22)
5. Specific assistance to individuals (line 23). This is unusual among the 389 largest supporting organizations, but did occur several times as scholarships and assistance to students, patients, and residents of supported organizations.
6. Benefits paid to members (line 24). This, too, is unusual.
7. Other expenses (line 43a-e), with itemized detail often found in attached schedules.
8. Accounts receivable (line 47a)
9. Other notes and loans receivable (line 51a)
10. Other assets (line 58)

Table 5 shows where evidence of support was found on the IRS Form 990 for the sample of 36 organizations.<sup>7</sup> Most striking is the wide variation in the way that the supporting organizations report their transfers to their supported organizations. Ten separate lines reflect funds flowing from the supporting organizations to their supported organizations. Although the sample was drawn exclusively from organizations that did **not** report any transfers in lines 16, 22, 23, or 24 in FY 2001, this table shows that at least one-quarter of the organizations did report grants in line 22 in other years examined. Fifty percent included transfers to supported organizations in “other expenses” (line 43) in at least one year.

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<sup>7</sup> Unlike the list above, this table includes indirect support and transfers *from* the supporting organization.

	Reported at least once		Never		Direct transfer to supported organization?
	Number	Percent	Number	Percent	
Line 6a: Rental income from supported organizations	11	31%	25	69%	
Line 6b: Rental expense to supported organizations	5	14%	31	86%	Yes
Line 13: Program services provided to supported organizations	30	83%	6	17%	Yes
Line 14: Management and general expenses directly support supported organizations	28	78%	8	22%	
Line 15: Fundraising expenses directly support supported organizations	9	25%	27	75%	
Line 16: Payments to affiliates	1	3%	35	97%	Yes
Line 20: Other changes in net assets include transfers to/from supported organizations	20	56%	16	44%	Yes
Line 22: Cash grants to supported organizations	9	25%	27	75%	Yes
Line 22: Non-cash grants to supported organizations	1	3%	35	97%	Yes
Line 23: Specific assistance to individuals (through or on behalf of supported organizations)	0	0%	36	100%	Yes
Line 24: Member benefits paid (through or on behalf of supported organizations)	0	0%	36	100%	Yes
Line 43: Other expenses include direct transfers to supported organizations	18	50%	18	50%	Yes
Part IV: Balance Sheet contains amounts receivable from or payable to supported organizations (includes lines 47a, 51a, and 58)	28	78%	8	22%	Yes

*Source:* Analysis of IRS Form 990 returns spanning 1998–2004 for 36 supporting organizations reporting zero in FY 2001 for lines 16, 22, 23, and 24; having total assets more than \$50 million; and having program service revenue of less than \$1,000.

In Table 6, we compared supporting organizations’ level of support over a three-to-five-year period with their liquid net assets. Net assets, the difference between an organization’s assets and its liabilities, is often referred to as *net worth* or *fund balance*. We also excluded illiquid assets such as real estate and notes receivable that are not easily convertible to cash.

The table captures some of the complexity of the supporting organizations. Many organizations reported funds being transferred both *to* supported organizations and *from* supported organizations. Half of the supporting organizations provided at least some annual operating support in at least one year. Twenty-two percent provided endowment or capital support.

The last two sections in the table show other transfers between the supporting and supported organizations. Examples are transfers for the purpose of combining investment or debt management, or when a supporting organization is seeded by a supported organization to provide specific services or benefits for the supported organization. Funds flowed in both directions with similar frequencies. Nearly 40 percent of the supporting organizations transferred at least 5 percent of their liquid net assets to their supported organizations in at least one year. Nearly the exact same proportion received at least 5 percent of liquid net assets from its supported organization.

<b>Table 6: Level and Frequency of Financial Transactions Over 3–5 Years Between Supporting Organizations and Supported Organization(s) (N=36)</b>						
Frequency of Transactions	Level of Transactions as a % of Liquid Net Assets <sup>a</sup>				All Organizations	
	7% or More	5–7%	1–5%	None		
<b>Operating support to supported organization(s)</b>						
Annual	11%	8%	11%	0%	31%	
Periodic	0	3	14	0	17	
Once	0	3	0	0	3	
Never	0	0	0	50	50	
All organizations	11	14	25	50	100	
<b>Endowment or capital support to supported organization(s)</b>						
Annual	6	8	0	0	14	
Periodic	3	0	0	0	3	
Once	6	0	0	0	6	
Never	0	0	0	78	78	
All organizations	14	8	0	78	100	
<b>Transfers from supporting organization to supported organization(s)</b>						
Annual	11	0	3	0	14	
Periodic	14	8	0	0	22	
Once	6	0	6	0	11	
Never	0	0	0	53	53	
All organizations	31	8	8	53	100	
<b>Transfers from supported organization(s) to supporting organization</b>						
Annual	14	0	0	0	14	
Periodic	17	6	0	0	22	
Once	3	3	6	0	11	
Never	0	0	0	53	53	
All organizations	33	8	6	53	100	

*Source:* Analysis of IRS Form 990 returns spanning 1998–2004 for 36 supporting organizations reporting zero in FY 2001 for lines 16, 22, 23, and 24; having total assets more than \$50 million; and having program service revenue of less than \$1,000.

*Note:* Percentages may not add due to rounding.

## ESTIMATING “PAYOUT”

One can conceptualize the role of many supporting organizations as akin to private foundations or, especially when control is firmly in the hands of the supported organizations’ management,<sup>8</sup> the supporting organization may be better conceptualized as a manager of endowments or investments. Comparing the organizations to private foundations leads us to assume that the best supporting organizations are the ones that have the highest payouts. However, if the “endowment/investment manager” model is used as a frame of reference, then the best supporting organization may be the one that keeps its expenses and distributions to a minimum. Instead, success is measured by the extent to which its net assets can be increased to the level where it provides a reasonable cushion against a downturn in the economy or a platform for expansion.

There is no way to measure “payout rate” for supporting organizations that is precisely comparable to the calculation of payout rate for private foundations, which is specified on the private foundations’ IRS Form 990-PF. However, in order to quantify the activities discussed earlier, we have attempted to identify the costs of support—grants and supporting services—for our sample of organizations and compare them to their net assets for the organizations’ *most recent* IRS Form 990.<sup>9</sup> We included costs, even if reported as “other changes in net assets” or “other expenses,” if they appeared tied to the supporting role of the organization.

Table 7 shows three ways to think about the payout rate for supporting organizations. The first, total support as a percent of liquid net assets, reflects the performance of the group as a whole, giving proportionally greater weight to the larger organizations. For the sample as a whole, 9.0 percent of liquid net assets were distributed as support. The second indicator, average of payout rates, ignores differences in the size of the supporting organizations and simply represents the average of each of the payout rates. Excluding the six organizations with zero or negative liquid net assets or that reported only transfers *from* their supported organizations, the average of the payout rates was 13.1 percent. Both of these sets of rates shows that the supporting organizations’ payout levels exceed what would be expected of them if they were private foundations. The last column paints a more complex picture. It shows that 60 percent of the supporting organizations actually exceeded the 5 percent threshold that applies to private foundations for the most recent available fiscal year. If total net assets are used as the denominator, then only 53 percent of organizations met the test in a single year. However, if

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<sup>8</sup> This is the case for Types I and II supporting organizations, as defined in the applicable regulations under I.R.C. § 1.509(a)-4.

<sup>9</sup> Ideally, one would calculate support costs over a number of years and carry over large costs in one year to subsequent years, just as is done on the private foundations’ Form 990-PF. However, this task was beyond the scope of this study.

costs were averaged over several years (the effect of the carryover rules for calculating private foundation payout rates), then this percentage is likely to increase, as can be inferred from Table 6 by the substantial number of organizations that made periodic or one-time transfers to their supported organizations.

Furthermore, to the extent that the organizations are serving as asset holding companies for legitimate managerial purposes, we would expect many of them to report “payout” below 5 percent. Management of investment assets or real estate holdings, for example, may be for the long-term, not necessarily for yielding direct contributions in a given year. Payout is not easily determined in situations in which supporting organizations issue tax-exempt bonds on behalf of the organizations it supports, distributing those proceeds among supported organizations in the form of notes receivable and maintaining bond payments through interest and principal payments.

<b>Table 7: Summary of "Payout" Estimates in Most Recent Year Reported (N=36)</b>						
<b>Payout Based on Liquid Unrestricted and Permanently Restricted Net Assets</b>						
	Number	Total support	Liquid unrestricted & perm. restricted net assets <sup>a</sup>	Support as % of liquid unrestricted & perm. restricted net assets	Average of payout rates	% of organizations with 5% or higher "payout"
Grantmaking	9	\$113,654,293	\$722,615,014	15.7%	13.2%	66.7%
Operating	14	84,744,134	1,228,239,823	6.9	15.8	50.0
Both grantmaking & operating	7	111,930,082	1,507,751,975	7.4	6.4	71.4
Not applicable or unable to determine <sup>b</sup>	6	NA	NA	NA	NA	NA
<b>Total</b>	<b>36</b>	<b>\$310,328,509</b>	<b>\$3,458,606,812</b>	<b>9.0</b>	<b>13.1</b>	<b>60.0</b>
<b>Payout Based on Total Net Assets</b>						
	Number	Total support	Total net assets <sup>a</sup>	Support as % of total net assets	Average of payout rates	Percent of organizations with 5% or higher "payout"
Grantmaking	9	\$113,654,293	\$775,202,945	14.7%	12.3%	66.7%
Operating	14	84,744,134	1,745,768,854	4.9	10.0	42.9
Both grantmaking & operating	7	111,930,082	1,598,553,223	7.0	5.7	57.1
Not applicable or unable to determine <sup>b</sup>	6	NA	NA	NA	NA	NA
<b>Total</b>	<b>36</b>	<b>\$310,328,509</b>	<b>\$4,119,525,022</b>	<b>7.5</b>	<b>9.8</b>	<b>53.3</b>

<sup>a</sup> Net asset values are for the beginning of the year.

<sup>b</sup> Value of non-financial support cannot be determined, or net transfers are from supported to supporting organizations, financials include affiliates, or organization reported negative net assets.

Notes: Liquid net assets exclude long-term and limited-use assets such as real estate holdings, pledges receivable, and receivables from supported and affiliated organizations (with one exception in which real estate holdings were the sole basis for in-kind support.).

Total support includes grants and other program expenses, direct financial transfers, and the cost or value of vital services provided to the supported organization.

Total net assets is from Line 73 of Form 990.

## **SUPPORTING ORGANIZATIONS AS TAX SHELTERS**

There is concern that supporting organizations are growing at a rapid pace, and that this growth is being driven by their use as tax shelters for the wealthy.<sup>10</sup> We cannot address their use as tax shelters directly but we can offer circumstantial evidence showing that their rate of growth is not inconsistent with broad patterns of growth in the nonprofit sector. Table 8, which is limited to organizations filing annual IRS returns, shows the number of supporting organizations growing 45 percent in the past 15 years, slower than the rate for other public charities (49.9%) and private foundations (61.2%). This pattern repeats itself among organizations created since 2001, with the number of supporting organizations growing by only 11.1 percent compared to 12.9 and 15.9 percent for other public charities and private foundations, respectively.

The picture, however, is more complicated when we look at the largest organizations by level of assets. For groups with more than \$50 million in total assets, we see supporting organizations growing at a slightly faster rate (32.9%) in the past 15 years than private foundations (28.6%) and much faster than other public charities (14.8%). Standing alone, this statistic might be cause for concern about the recent growth of supporting organizations as tax shelters, but the growth rate of large supporting organizations has been higher than for large private foundations since 1971. While these statistics leave many unanswered questions, they nonetheless show no massive shift from the creation of private foundations to the creation of supporting organizations.<sup>11</sup>

It has also been argued that some supporting organizations with assets in the tens of millions of dollars in publicly traded stocks have developed complicated structures that permit them to evade the IRS Form 990 filing requirements by generating no reportable gross receipts, an option available to public charities but not to private foundations.<sup>12</sup> Substantial management fees may be paid regularly to “insiders” but with no sale of stock, their gross receipts stay below the \$25,000 gross receipts Form 990 filing threshold. Once again, although we have no information to determine precisely how often this occurs, we can use available data to understand the potential magnitude of the phenomenon. Table 9 shows the percentage of supporting organizations, other public charities, and private foundations that file IRS Form 990s with the IRS. Overall, it shows that the percentage of supporting organizations filing IRS Form 990s

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<sup>10</sup> See, for example, *New York Times*, April 25, 2005, “A Tax Shelter for Big Donors Often Bypasses Idea of Charity”.

<sup>11</sup> The number of unanswered questions is large. For example, it remains possible that the newer supporting organizations are primarily Type III organizations, which offer donors greater ability to shelter wealth. Collection of the organizations’ IRS Form 1023s would help us assess this.

<sup>12</sup> All private foundations are required to complete the IRS Form 990-PF annually regardless of their level of income, while public charities must complete a Form 990 only if their gross receipts exceed \$25,000.

(68.1%) is relatively close to the filing rate for private foundations (72.9%) and far higher than for other public charities.<sup>13</sup> For organizations that are less than 15 years old, the difference between supporting organization and private foundation filing rates is only 2.3 percent, an indication that there is no large-scale evasion of filing requirements by the supporting organizations. We do, however, see a substantial drop-off in the filing rates for supporting organizations created since the beginning of 2001. It is conceivable that this reflects intentional evasion of filing requirements; however, it seems more likely to reflect the fact that far fewer public charities—supporting or non-supporting—generate revenue in their first few years of existence than mature organizations. Thus, the filing percentage drops by 13.4 percent for *other public charities* from the 1996–2000 period to the latest period. The drop for supporting organizations is only slightly higher, 16.1 percent, and the absolute level, 57.9 percent, is still well above the percentage for other public charities.

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<sup>13</sup> The filing rate for private foundations is surprisingly low given that *all* private foundations are required to file the IRS Form 990-PF. However, it appears that many of the private foundations registered with the IRS fail to survive and, subsequently, do not file their forms with the IRS. Many of the organizations that initially sought public charity status from the IRS—thus entitling their donors to deduct 100 percent of the value of their contributions—were later deemed by the IRS to fail the public charity “public support” requirements and were reclassified as private foundations. Many of these so-called “failed public charities” seem particularly likely to fail altogether. An IRS survey of a random sample of the non-filers (not limited to private foundations) in 1994 found that 21 percent of the organizations listed in the IRS Business Master File could not be located. [U.S. Internal Revenue Service, *Exempt Organizations Nonfiler Study: How Many Nonprofit Organizations Are There? Assessing the Quality of the IRS Business Master File (BMF)*.

<http://nccsdataweb.urban.org/FAQ/detail.php?linkID=102&category=25&xrefID=1924.>

<b>Table 8: Distribution of 501(c)(3) Organizations by IRS Ruling Date and Total Assets, 2003</b>								
	Less than \$100,000	\$100,000– 500,000	\$500,000– \$1 mil.	\$1–5 mil.	\$5–25 mil.	\$25–50 mil.	\$50 mil. or more	Total
<b>Supporting Organizations</b>								
15 or more years old	51.8%	54.3%	53.0%	55.5%	59.2%	64.4%	67.1%	54.9%
Not available	1.6	1.8	1.8	2.1	2.0	0.9	1.9	1.8
1900–1950	3.9	3.3	3.7	5.6	8.0	13.0	11.8	5.0
1951–1970	12.4	13.1	12.1	11.7	11.1	12.1	11.1	12.2
1971–1980	14.6	14.7	12.9	13.8	12.6	11.9	10.4	13.9
1981–1985	8.7	9.6	10.0	9.5	11.7	13.4	19.1	10.0
1986–1990	10.5	11.8	12.4	12.8	13.9	13.0	12.9	12.1
Less than 15 years old	48.2%	45.7%	47.0%	44.5%	40.8%	35.6%	32.9%	45.1%
1991–1995	14.2	15.6	16.7	15.6	13.7	10.6	10.5	14.9
1996–2000	19.1	18.7	19.8	19.9	19.2	16.8	16.2	19.2
2001 or newer	14.9	11.3	10.6	9.0	8.0	8.3	6.2	11.1
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
Number of orgs.	8,222	6,668	3,655	7,030	3,471	662	858	30,566
<b>Other Public Charities</b>								
15 or more years old	36.5%	51.6%	60.7%	68.3%	75.5%	81.5%	85.2%	50.1%
NA	1.1	1.1	1.2	1.2	1.1	0.4	0.4	1.1
1900–1950	1.7	2.1	3.5	7.0	14.7	27.3	40.9	4.3
1951–1970	6.8	8.6	12.1	16.8	22.8	24.2	22.1	10.4
1971–1980	9.9	15.2	18.0	19.9	18.9	14.4	9.9	13.9
1981–1985	7.8	11.6	12.4	12.2	9.2	7.5	6.4	9.8
1986–1990	9.3	13.0	13.3	11.1	8.8	7.7	5.5	10.7
Less than 15 years old	63.5%	48.4%	39.3%	31.7%	24.5%	18.5%	14.8%	49.9%
1991–1995	16.4	18.0	16.4	14.2	10.6	8.1	5.4	15.9
1996–2000	26.8	20.6	16.7	13.0	10.6	7.9	7.4	21.1
2001 or newer	20.3	9.8	6.2	4.5	3.3	2.6	2.0	12.9
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
Number of orgs.	115,705	63,325	22,827	36,081	14,310	2,509	3,960	258,717
<b>Private Foundations</b>								
15 or more years old	31.6%	37.1%	37.5%	44.0%	55.8%	64.1%	71.4%	38.8%
NA	1.0	1.3	1.1	1.0	0.9	1.1	0.7	1.1
1900–1950	0.8	1.9	2.5	3.7	6.5	9.9	15.1	2.6
1951–1970	8.4	12.1	12.2	14.9	21.1	24.6	29.1	12.5
1971–1980	5.3	5.7	6.0	6.3	7.9	8.9	9.1	6.0
1981–1985	5.5	5.4	5.7	6.1	7.0	7.7	7.2	5.8
1986–1990	10.5	10.7	10.0	11.9	12.5	11.9	10.1	10.9
Less than 15 years old	68.4%	62.9%	62.5%	56.0%	44.2%	35.9%	28.6%	61.2%
1991–1995	14.8	14.2	14.4	15.6	15.9	13.0	10.9	14.8
1996–2000	33.6	31.6	32.9	27.8	20.8	16.4	13.2	30.5
2001 or newer	20.0	17.1	15.2	12.6	7.5	6.5	4.5	15.9
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
Number of orgs.	24,082	19,585	9,537	14,694	5,384	913	938	75,133
<i>Sources: National Center for Charitable Statistics Core Public Charity File, Fiscal Year circa 2003; IRS Business Master File 12/2004 (for private foundation analysis only).</i>								

**Table 9: Percentage of 501(c)(3) Organizations Filing IRS Forms**

	Supporting Organizations		Other Public Charities		Private Foundations	
	Number	% filing	Number	% filing	Number	% filing
15 or more years old	15,050	67.9	395,163	35.8	33,396	87.4
NA	338	76.3	7,901	30.4	913	88.0
1900–1950	1,110	62.0	45,967	28.0	2,042	95.4
1951–1970	3,119	67.2	103,405	28.4	10,007	93.8
1971–1980	3,868	66.0	102,424	38.3	5,111	88.0
1981–1985	2,829	69.9	61,736	44.6	5,256	82.3
1986–1990	3,786	70.1	73,730	41.0	10,067	81.5
Less than 15 years old	16,408	68.3	398,902	39.1	69,672	66.0
1991–1995	4,846	71.2	105,323	43.1	18,432	60.1
1996–2000	6,601	74.0	138,596	44.7	35,544	64.4
2001 or newer	4,961	57.9	154,983	31.3	15,696	76.3
Total	31,458	68.1	794,065	37.5	103,068	72.9

Source: IRS Business Master File December 2004

Note: "Percentage Filing" includes organizations filing an IRS Form 990 or 990-PF for fiscal years 2003 or 2004.

## CONCLUSIONS

Supporting organizations provide a broad array of services, including grants and other financial benefits, to the organizations they support. For the most part, supporting organizations defy easy generalization or simple prescriptions for improvement. We found that 33 of the 36 supporting organizations we examined in depth (nearly 92%) provided significant financial services and benefits and other services to their supported organizations. Complex business and legal reasons similar to those found in the for-profit world appear to lie behind the activities of most of the organizations, not efforts by donors to shelter their funds. The fact that nearly 90 percent of these organizations are Type I or II supporting organizations, which are either controlled by or in conjunction with their supporting organizations, is further reason to allay policymakers' concerns about these organizations.

Better reporting by supporting organizations could solve some of the issues addressed in this paper. There appears to be no rationale for organizations not to report "transfers of net assets" to supported organizations as "grants." The IRS instructions seem quite clear on this and discussions with knowledgeable accountants point to the same conclusion. Overuse of "other expenses" is a major problem for all exempt organizations, not just supporting organizations.

Once again, the instructions seem clear but the IRS has not had the resources to enforce compliance with the instructions.

Type III supporting organizations have been the source of greatest concern to regulators and policymakers. Our understanding of these organizations would benefit from future research focused on this group. The first step in this research would be, in all likelihood, to obtain copies of a sample of supporting organizations' IRS Form 1023s to determine if they initially identified themselves as Type III organizations when applying for exempt status with the IRS. The second step could involve an analysis of a sample of Type III organizations similar to the one presented in this study or it could be extended to include analyses of other regulatory filings, interviews, or other documents.