

IPCF Procedure for Due Diligence

Advisory Fund Grantee Organizations – Tax Status Determination

Under the Pension Reform Act of 2006, community foundations are required to determine the tax status of organizations named to receive grants from advisory funds. Organizations listed in Section 170(b)(1)(A) of the IRS Code do not require any further investigation. However, the following types of organizations require "expenditure responsibility" for grants made to them from advisory funds: (1) organizations other than those listed in Section 170(b)(1)(A), (2) type III organizations that are not functionally integrated and (3) any supporting organization if the grantee supporting organization is controlled by the donor or donor appointee.

To fulfill this requirement, we are keeping a written file of the IRS determination letters of all organizations receiving grants from our advisory funds. For those organizations not providing or having an IRS letter, we access the IRS Business Master File on the IRS website and make a notation of each such organization for our file. These notations include the grantee's name, public charity classification, date of search and origin of information (the IRS Business Master File).

For those organizations requiring expenditure responsibility (see above three instances), we ensure that grants are spent only for their intended purposes by following the regulations for expenditure responsibility (see final section of this document).

Step 1 – Obtaining Information

The IRS Business Master File is a searchable, up-to-date database of tax-exempt organizations. It is available through the IRS website at the following address:

<http://www.irs.gov/taxstats/charitablestats/article/0,,id=97186,00.html>

At the bottom of the page is a list of states. Click on the state where the charity is headquartered. A dialog box will appear – click "Run." (A message may appear asking if you want to run the program even though the publisher could not be verified – click "Yes.") A black dialog box will briefly appear, then close itself. If it gives an option to overwrite, push "Y" on keyboard. A compressed data file of all tax-exempt charities in the state will be downloaded into a file located on your desktop.

Once the file is saved, go to your desktop and look for an icon with a name beginning with "EO" (abbreviation for "Exempt Organizations"), such as "EO_IL". Put cursor on square in middle of icon and it will give day and time the information was updated. If this information does not appear, click on the icon – once it darkens, put cursor on square again.

Open the file one of the following two ways.

1. Double click on the icon to open it. If you get a message that states that it is an unknown type, select "choose from a list" and choose the Notepad option.
2. Right click on the icon and choose the option "Open With". Scroll through the dialog box until you find the Notepad option, highlight it and click "OK."

Step 2 – Determining Codes

Once it is open, search for the particular organization by typing Ctrl-F to open a search dialog box. Type in a key word from the organization name and select "Search". When you find the correct line, move your cursor – NOT the tab key as this moves the information – to the second column of numbers after the city.

This second column of numbers will begin with the year (four digits) and month (2 digits) that the organization received its tax-exempt status. The seventh digit in the block will probably be a 1, indicating that contributions are deductible.

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Step 3 – Determining Type

If the grantee organization is a supporting organization (code 17), determine if it is a Type I, Type II or Type III (functionally integrated) organization in one of the following two ways:

1. Grantee organization may provide:
 - a. Documentation describing the selection process of its officers and directors
 - b. Documentation referencing the pertinent provisions of their organizing documents that establishes their relationship to its supported organizations
2. Collect and review copies of the grantee's governing documents. If they are not sufficient to establish the relationship, collect organizing documents from the supported organization.

Type Determination	
Type Number	Description
I	"operated, supervised, or controlled by" the supported organization
II	"supervised or controlled in connection with" the supported organization These are the rarest types of organizations.
III	"operated in connection with" the supported organization These will most commonly be organizations that were NOT established by the supported organization, but rather by a private individual.

Collect the following to determine if a Type III organization is functionally integrated:

1. Letter from the grantee identifying the organizations it supports
2. Grantee organization's documents (and those of the supported organizations, if necessary)
3. Letter signed by an officer, director, or trustee of each supported organization that the supporting organization is functionally integrated and that but for the involvement of the supporting organization, the supported organization normally would engage in those activities itself.

If a Type III supporting organization is NOT functionally integrated, expenditure responsibility is required for grants from donor-advised funds.

Expenditure responsibility is also required for grants to any type of supporting organization if the donor advisor (or related parties) of a donor-advised fund controls the supporting organization or an organization that the supporting organization supports.

Expenditure responsibility requires:

1. Conducting a pre-grant inquiry including a reasonable investigation of the grantee to ensure that the proposed activity is charitable and that the grantee is able to perform the proposed activity.
2. Executing a written agreement with the grantee that specifies the charitable purposes of the grant and includes provisions that prohibit use of the funds for lobbying activities and require the grantee to return any funds not used for the designated purposes.
3. Requiring the grantee to maintain the grant funds in a separate fund so that charitable funds are segregated from non-charitable funds.

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4. Requiring the grantee to provide regular reports on the use of the funds and the charitable activity supported by the grant.
5. Including a report on Form 990 about the grant including a brief description of the grant, the amount, the charitable purpose and the current status of the grant.

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The next two digits located after the 1 represent the Foundation Code and the section of the Internal Revenue Code that best categorizes the type of non-profit, listed as follows:

Be sure to always start a new search from the top by pushing "control – home." Otherwise the information will not be found.

FOUNDATION CODE				
All 501(c)(3) organizations are classified as private foundations unless granted public charity status under one of the exceptions found in Section 509(a).				
Code Number	Description	Tax Status	Public Charity Status	Public Charity Classification
02	Private operating foundation exempt from paying excise taxes on investment income	501(c)(3)	no	no
03	Private operating foundation (other)	501(c)(3)	no	no
04	Private non-operating foundation	501(c)(3)	no	no
10	Church	501(c)(3)	509(a)(1)	170(b)(1)(A)(i)
11	School	501(c)(3)	509(a)(1)	170(b)(1)(A)(ii)
12	Hospital or medical research organization	501(c)(3)	509(a)(1)	170(b)(1)(A)(iii)
13	Organization which operates for benefit of college or university and is owned or operated by a governmental unit	501(c)(3)	509(a)(1)	170(b)(1)(A)(iv)
14	Governmental unit	501(c)(3)	509(a)(1)	170(b)(1)(A)(v)
15	Organization which receives a substantial part of its support from a governmental unit or the general public	501(c)(3)	509(a)(1)	170(b)(1)(A)(vi)
16	Organization that normally receives no more than one-third of its support from gross investment income and unrelated business income and at the same time more than one-third of its support from contributions, fees, and gross receipts related to exempt purposes	501(c)(3)	509(a)(2)	170(b)(1)(A)(viii)
17	Organizations operated solely for the benefit of and in conjunction with organizations described in 10 through 16 above (Supporting Organizations)	501(c)(3)	509(a)(3)	Supports 509(a)(1) and 509(a)(2) organizations
18	Organization organized and operated to test for public safety	501(c)(3)	509(a)(4)	

Only organizations with a code of "17" are supporting organizations governed by 509(a)(3).

On the distribution request form from the donor, indicate the following:

1. Section identification code that governs the organization type
2. Source of information (e.g. IRS Master File)
3. Date and signature

Example: 170(b)(1)(A)(ii) from IRS Master File as of 12/18/06. (Sign your name)