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RECENT COURT DECISIONS ANALYZE THE RULES GOVERNING "TYPE 3" SUPPORTING ORGANIZATIONS[1]

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Introduction

In two separate decisions, the Tax Court concluded that two organizations failed to qualify for recognition as supporting organizations under section 509(a)(3) of the Internal Revenue Code of 1986, as amended (the "code"),[2] and therefore would be classified as private foundations.[3] These cases highlight the complexity, and to some degree the subjectivity, inherent in the regulations that govern "Type 3" supporting organizations. The cases also illustrate the difficulty that a newly formed organization may have in demonstrating to the IRS that it satisfies the tests required to qualify for recognition as a Type 3 supporting organization.

Background

Supporting Organizations Generally

In summary, supporting organizations are 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;[4] are operated, supervised or controlled by or in connection with one or more public

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2 Unless otherwise indicated, all "section" references are to the code.

3 *Lapham Foundation Inc. v. Commissioner*, T.C. Memo 2002-293; The E.O.T.R., January 2003, p. 128; Doc 2002-26447 (35 o.p.); 2002 TNT 230-7; *Christie E. Cuddeback and Lucille M. Cuddeback Memorial Fund v. Commissioner*, T.C. Memo 2002-300; The E.O.T.R., January 2003, p. 137; Doc 2002-26917 (35 o.p.); 2002 TNT 236-47.

4 In lieu of, or in addition to, supporting a 509(a)(1) or 509(a)(2) organization, a supporting organization may support a 501(c)(4), 501(c)(5), or 501(c)(6) organization that would qualify as a 509(a)(2) organization if it were a 501(c)(3) organization. *See* section 509(a).

charities; and are not controlled directly or indirectly by a disqualified person.[5] Organizations that qualify for recognition as supporting organizations under section 509(a)(3) are excluded from the definition of "private foundation" and therefore enjoy the same favorable tax treatment as other types of public charities.

In order for an organization to qualify for recognition as a supporting organization under section 509(a)(3), it must demonstrate one of three types of relationships with the public charity it supports (the "supported charity"), as set forth below. The purpose behind this required relationship is to ensure that the supporting organization is responsive to the needs or demands of the supported charity and the supporting organization constitutes an integral part of, or maintains a significant involvement in, the operations of the supported charity.[6]

> (1) The Type 1 supporting organization is "operated, supervised, or controlled by one or more public charities," which the regulations analogize to a "parent-subsidiary" relationship;[7]
>
> (2) the Type 2 supporting organization is "supervised or controlled in connection with" one or more public charities, like "brother-sister" organizations;[8] and
>
> (3) the Type 3 supporting organization is "operated in connection with" one or more public charities.[9]

Type 3 Supporting Organizations

The organizations that are the subject of the cases discussed in this article sought recognition as Type 3 supporting organizations. Of the three types, Type 3 supporting organizations require the least supervision and control by the supported charity. However, in exchange for this independence, Type 3 supporting organizations still must demonstrate a sufficient nexus with the supported charity, as set forth in detailed regulations. In particular, the regulations set forth two tests that must be satisfied by organizations seeking recognition as Type 3 supporting organizations: a responsiveness test and an integral part test. The Tax Court summarized the policy behind these two tests, as follows:

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5 Section 509(a)(3)(A), (B), and (C).

6 Treas. Reg. § 1.509(a)-4(f)(3).

7 Treas. Reg. § 1.509(a)-4(g)(1).

8 Treas. Reg. § 1.509(a)-4(h)(1).

9 Treas. Reg. § 1.509(a)-4(i).

> "While the responsiveness test guarantees that the supported organization will have the ability to influence the supporting organization's activities, the integral part test insures that the supported organization will have the motivation to do so."[10]

To satisfy the responsiveness test, the supporting organization must show the IRS how it is responsive to the needs or demands of the supported charity. The supported charity must have a significant voice in the supporting organization's investment policies, the timing of and manner of making grants, the selection of recipients and in directing the use of the income or assets of the supporting organization.[11] If the supporting organization is a trust, the responsiveness test will be satisfied if the supported charity is a named beneficiary of the trust and has enforcement powers as to the trust under state law.[12]

The main focus of the court in the cases discussed in this article was the integral part test. To satisfy the integral part test, the supporting organization must maintain a significant involvement in the operations of the supported charity and the supported charity must in turn be *dependent* upon the supporting organization for the type of support that it provides.[13] The integral part test can be satisfied in one of two alternate ways, as follows:

"But For." The supporting organization engages in activities that perform the functions of, or carry out the purposes of, the supported charity and, but for the involvement of the supporting organization, such activities would normally be carried out by the supported charity itself.[14]

"Substantially All." The supporting organization makes payment of substantially all[15] of its income to or for the use of the supported charity, and the amount of support is sufficient to

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10 *Nellie Callahan Scholarship Fund v. Commissioner*, 73 T.C. 626, 637-638 (1980).

11 Treas. Reg. § 1.509(a)-4(i)(2)(ii).

12 Treas. Reg. § 1.509(a)-4(i)(2)(iii).

13 Treas. Reg. § 1.509(a)-4(i)(3)(i).

14 Treas. Reg. § 1.509(a)-4(i)(3)(ii).

15 "Substantially all" has been interpreted to require that the supporting organization distribute at least 85 percent of its income to one or more supported charities. *See* Rev. Rul. 76-208 (1976). The IRS has stated that accumulations of income in some years are acceptable if the accumulations are not extended and the income is ultimately distributed to the supported charity. *See* GCM 36523 (December 18, 1975).

ensure the "*attentiveness*" of the supported charity to the supporting organization. The amount of support received by the supported charity must represent a sufficient part of the supported charity's total support so as to ensure attentiveness.[16] If it does not, the integral part test may still be satisfied if it can be demonstrated that in order to avoid the "*interruption*" of the carrying on of a particular function or activity, the supported charity will be sufficiently attentive to the operations of the supporting organization. This may be the case where the support received from the supporting organization is earmarked for a particular program or activity. The particular program or activity need not be the primary activity of the supported charity, but it must be a substantial one.[17] The regulations cite as examples a chamber music series at a museum and an endowed chair of international law at a law school.[18]

In determining whether the amount of support received by the supported charity is sufficient to ensure the attentiveness of the organization to the supporting organization, the regulations provide that "all pertinent factors" will be considered, including (i) the number of supported charities; (ii) the length and nature of the relationship between the supported charity and the supporting organization; and (iii) the purpose for which the funds are used. The more substantial the amount of support in terms of the supported charity's total support, the greater the likelihood that sufficient attentiveness will be present. Evidence of actual attentiveness, however, is of "almost equal importance."[19] For example, the regulations cite as acceptable evidence of actual attentiveness the imposition of a requirement that the supporting organization furnish reports at least annually to the supported charity to assist the charity in ensuring that the supporting organization has invested its endowment in assets that produce a reasonable rate of return and has not engaged in any activity that would give rise to a penalty excise tax if the supporting organization were classified as a private foundation.[20]

The Cases

Lapham

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16 Treas. Reg. § 1.509(a)-4(i)(3)(iii)(a).

17 Treas. Reg. § 1.509(a)-4(i)(3)(iii)(b).

18 Treas. Reg. § 1.509(a)-4(i)(3)(iii)(c).

19 Treas. Reg. § 1.509(a)-4(i)(3)(iii)(d).

20 Treas. Reg. § 1.509(a)-4(3)(iii)(d). The IRS, however, has stated that it does not accept the position that there is a safe harbor for achieving attentiveness simply by virtue of a large grant and providing annual reports to the supported charity. *See* INTERNAL REVENUE SERVICE CONTINUING PROFESSIONAL EDUCATION TEXT FOR FISCAL YEAR 1997, CHAPTER I., "*Public Charity Status on the Razor's Edge.*"

The Lapham Foundation (the "Lapham Foundation" or the "Foundation") was formed on December 29, 1998 to operate exclusively for the benefit of The American Endowment Foundation (AEF), an Ohio nonprofit corporation exempt as an organization described under section 501(c)(3) and qualified as a public charity under section 509(a)(1).[21] AEF is a community foundation that benefits the community consisting of the "inhabitants of the United States of America."[22] AEF operates a donor-advised fund program pursuant to which donors are entitled to make non-binding recommendations regarding the charitable use or beneficiaries of their contributions. The ultimate decision with respect to the timing, manner, and recipient of any distribution lies with AEF.[23]

Upon formation, the Lapham Foundation received from Charles and Maxine Lapham a contribution of a promissory note in the face amount of approximately $1.5 million. The obligor under the note was a family business controlled by the Laphams. The note was payable in quarterly interest-only installments of approximately $30,000 and principal on the note was due in December 2013.[24] Contemporaneously with the contribution of the note, the Laphams entered into a charitable gift annuity agreement whereby the Foundation agreed to pay the Laphams an annual annuity of approximately $116,000 over the joint lives of the Laphams, payable in quarterly installments of approximately $29,000.[25]

The Lapham Foundation's Form 1023 stated that the Foundation intended to pay at least 85 percent of its income to a donor-advised fund account at AEF and in that regard anticipated an annual contribution of approximately $7,600.[26] In correspondence with the IRS, the Foundation stated that one-third of its contributions to its donor-advised fund account at AEF would be recommended to support activities in southeastern Michigan and two-thirds would be recommended to support charities in Northville, Michigan.[27]

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21 *Lapham*, T.C. Memo 2002-293, at 2-4.

22 *Id.* at 4-5.

23 *Id.* at 6.

24 *Id.* at 3-4.

25 *Id.* at 8.

26 *Id.* at 10.

27 *Id.* at 11.

The IRS issued an adverse ruling regarding the Foundation's status as a supporting organization, on two grounds.[28] First, the IRS determined that the Foundation failed to satisfy the "attentiveness" requirement under the integral part test. Second, the IRS determined that disqualified persons controlled the Foundation. In particular, because the Foundation's primary asset was a promissory note secured by assets of a corporation controlled by the Laphams, the IRS determined that the Laphams are in a position to control the Foundation by means of the power they exercise over the Foundation's primary asset.[29]

During the administrative process, the IRS also claimed that the Lapham Foundation failed to satisfy the responsiveness test, alleging that the AEF-appointed director lacked the requisite "significant voice" in the activities of the Foundation.[30] However, the court found that the IRS did not satisfy its burden in that regard. The court noted that although the Foundation had few assets requiring active management, the IRS had not shown that future revenue would not be earned to render the management role increasingly material. Moreover, the court stated that certain of the IRS' statements "seem to conflate influence with control" to a degree unsupported by the regulations and the case law.[31] Interestingly, the court noted favorably the fact that the AEF-appointed director would serve on the advisory committee of the Foundation's donor-advised fund account at AEF and would therefore have a significant voice in recommending grants. The court also noted favorably the fact that AEF exercises final authority over distributions from the Foundation's donor-advised fund account because the Foundation may only make non-binding recommendations.[32]

The court next analyzed whether the Foundation satisfied the integral part test, and concluded it did not. First, the court addressed the "but for" test and noted that this test has been interpreted by the Tax Court to generally apply to situations where the supporting organization actually engages in specific functions or activities, as opposed to mere grant

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28 After the IRS issued a proposed adverse ruling as to its supporting organization status, the Foundation proposed to amend its articles of incorporation to include the First Presbyterian Church of Northville, Michigan and the Boy Scouts of America Detroit Area Council as supported charities. However, on procedural grounds, the court reached its decision without considering these proposed changes. *Id.* at 27-31.

29 *Id.* at 15-16.

30 *Id.* at 34.

31 *Id.* at 35-36.

32 *Id.* at 36.

making.[33] Similarly, the IRS argued that the "but for" test applies only in cases where the supporting organization's involvement extends beyond mere grant making.[34] The court did not reach a definitive view on this issue in this case because it found that the Foundation did not satisfy the second prong of the "but for" test, namely that but for the involvement of the supporting organization, the activities carried out by the supporting organization would normally be engaged in by the supported charity itself. The Foundation argued that it was providing the only support for AEF's activities in Northville, Michigan and therefore, but for the Foundation's support, those activities would not exist. However, according to the court, AEF is not bound by the Foundation's recommendations and theoretically could use the Foundation's support anywhere in the United States. Moreover, the court found that distributing grant funds is an activity in which AEF is and will continue to be engaged regardless of the Foundation's support. The Foundation, therefore, could not demonstrate the type of dependency required by the "but for" test.[35]

The court next turned to the "substantially all" test, focusing in particular on the requirement that the amount of support received by the supported charity ensure the attentiveness of the supported charity and that the amount of support represent a sufficient part of the supported charity's total support so as to ensure attentiveness. The court found that anticipated annual contributions from the Foundation of $7,600, when measured against annual contributions received by AEF in excess of $7 million, was not sufficient to ensure attentiveness.[36]

But the Foundation argued that it supported a particular activity of AEF -- supporting charities in Northville, Michigan – and that without the Foundation's support, this activity would be interrupted.[37] The court did not accept this argument. First, the court stated that this approach is available only if the supporting organization or the supported charity earmarks the support. Because the Foundation could make only non-binding recommendations with respect to its donor-advised fund account, it could not earmark its contributions. Moreover, the Foundation had not established that AEF had earmarked the Foundation's contributions. Second, the court stated that there was no evidence that benefiting Northville, Michigan is a

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33 *Id.* at 38, *citing* Roe Foundation Charitable Trust v. Commissioner, T.C. Memo 1989-566, at 89-2810.

34 *Lapham,* T.C. Memo 2002-293, at 38-39.

35 *Id*. at 39-41.

36 *Id.* at 42-43.

37 *Id.* at 44.

substantial activity of AEF or that AEF's minimal expenditures in Michigan would be interrupted absent the Foundation's support.[38]

Finally, the Foundation argued that evidence of AEF's actual attentiveness existed, citing the Foundation's intention to provide AEF with annual reports and AEF's appointment of a Northville, Michigan resident to the Foundation's Board. The court was not persuaded. In light of the vast difference in the size and scope of the programs of the Foundation and AEF, establishing attentiveness would require more than "pointing to a few administrative formalities."[39]

Accordingly, the court concluded that the Lapham Foundation should be classified as a private foundation.[40]

Cuddeback

The Christie E. Cuddeback and Lucille M. Cuddeback Memorial Fund (the "Cuddeback Fund" or the "Fund") was created as a testamentary trust. Upon the death of the testator's niece, the income of the Cuddeback Fund was to be paid to three organizations – two churches and a section 509(a)(1) nursing home care facility, Keswick Multi-Care Center ("Keswick"). The two churches were each to receive 10 percent of the Cuddeback Fund's income and Keswick was to receive 80 percent.[41]

In conjunction with its adult daycare program, Keswick offers grants to some participants who could not otherwise afford to pay Keswick's charges.[42] The testator's will provided that the income paid to Keswick should be used by it "to cover not more than one-half (1/2) of the cost of such elderly persons enrolled in the Day Care Program operated by Keswick, who do not have financial means to pay all costs thereof."[43]

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38 *Id.* at 44-45. Because the court ruled that the Foundation did not satisfy the integral part test, it did not reach the question of whether the Foundation was controlled by disqualified persons by virtue of the Laphams' control of the Foundation's primary asset. *Id. at 45.*

39 *Id.* at 43-44.

40 *Id.* at 46.

41 *Cuddeback,* T.C. Memo 2002-300, at 2-4.

42 *Id.* at 4.

43 *Id.*

Several years after the death of the testator and her niece, the Cuddeback Fund filed a Form 1023 seeking recognition as a supporting organization.[44] Along with the Form 1023, the Cuddeback Fund submitted a letter from Keswick's chief financial officer describing the Fund's participation in Keswick's activities.[45] Nonetheless, the IRS issued a proposed adverse ruling, concluding that the support provided by the Cuddeback Fund was not sufficient to ensure Keswick's attentiveness and that therefore the Fund did not satisfy the integral part test.[46]

In its appeal, the Cuddeback Fund argued that Keswick's adult day care program is a substantial activity and that without the Fund's support, the "grant program" would be interrupted. Accordingly, the Fund argued that its support of Keswick's grant program would ensure the attentiveness of Keswick.[47] The Fund also submitted supplemental letters from Keswick with additional information regarding the number of participants in the adult daycare program and the extent to which the Fund's support defrayed the costs of the grant program. The correspondence from Keswick claimed that without the Cuddeback Fund's support, there would be a "significant reduction in the number of seniors served" at Keswick.[48] Nonetheless, the IRS issued a final adverse ruling that the Fund failed to qualify as a supporting organization.[49]

The Cuddeback Fund did not claim to satisfy the "but for" test, and the court noted that the Fund does not engage in any activities on behalf of Keswick, other than distributing funds to Keswick.[50] Therefore, the court's analysis focused on the "substantially all" test, and in particular on the "attentiveness" requirement. The Fund and the IRS disputed several key points: (i) whether the Fund's support was earmarked for the adult daycare program generally or specifically for a program to provide support to needy participants; (ii) whether "interruption" means discontinuance of a program, as opposed to curtailment; and (iii) whether the adult daycare program and the grant programs are "substantial" activities as required by

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44 *Id.* at 6.

45 *Id.* at 6-7.

46 *Id.* at 9-10.

47 *Id.* at 11.

48 *Id.*

49 *Id.* at 12-14.

50 *Id.* at 22.

the regulations.[51] The court, in large part, did not resolve these questions. Rather, in ruling against the Fund, the court relied on what it viewed as a sketchy and inconsistent record. According to the court, the record did not provide sufficient information to evaluate the financial impact of the adult daycare program or the grant program on Keswick as a whole, and critically, the impact the Cuddeback Fund's support had on these programs.[52] The court emphasized that the existence of other funding sources for the grant program suggested that Keswick might not depend on the Fund to the extent asserted by the Fund and Keswick.[53] The court held that the Fund did not demonstrate that Keswick would be sufficiently attentive to the Fund's operations in order to avoid an interruption of either the adult daycare program or a program to provide grants to needy participants.[54] In addition, the court found that there was no evidence that Keswick exercised actual attentiveness, notwithstanding Keswick's letters of support to the contrary.[55]

Accordingly, the court did not resolve the interesting question of whether interruption requires actual discontinuance of a program or activity, as the IRS argued.

Lessons Learned from the Cases

A number of lessons may be learned from these cases.

First, the facts must support the required relationship.

The *Lapham* and *Cuddeback* cases illustrate the importance of a factual record that can support the relationship required by the regulations. The court in *Cuddeback* relied heavily on what it viewed as an incomplete and inconsistent record in reaching its decision. Despite several supportive letters submitted by Keswick, the court nonetheless concluded that the record did not provide sufficient information to conclude that Keswick would be attentive to the Cuddeback Fund. Although the *Lapham* case did not suffer from a deficient record, the facts convinced the court that the Lapham Foundation's support was insubstantial in relation to AEF's overall support.

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51 *Id.* at 32-33.

52 *Id.* at 33-43.

53 *Id.* at 39-40.

54 *Id.* at 43.

55 *Id.* at 44.

Moreover, newly formed organizations may face a particular challenge in demonstrating attentiveness because there is no history of its support of the supported charity. This is not necessarily an insurmountable obstacle so long as the organization's anticipated contributions in relation to the total support of the supported charity or a specific and identifiable program of the charity is sufficient to persuade the IRS that the supported charity will be dependent upon the organization, and therefore attentive to the supporting organization.

But the cases also illustrate the inherent subjectivity of the regulations. Attentiveness and dependence are not necessarily quantifiable, and to rely solely on numerical information to draw conclusions in this regard can possibly yield disparate results. For example, in another Tax Court case from 1986, the income from a testamentary trust was to be used to provide scholarships to students attending college in Oregon, with a preference for students attending Northwest Christian College ("Northwest").[56] Although the support provided by the trust amounted to only 8 percent of the scholarship funds at Northwest and affected only 9 percent of the full-time students, the court nonetheless found that there was sufficient evidence of actual attentiveness. The court took into account all of the pertinent circumstances, including the amount of funds distributed, the number of students affected, and the history and nature of the relationship between the trust and Northwest.[57] Testimony from Northwest's president that a reduction in funds from the trust would cause Northwest to "expend efforts to obtain offsetting funds elsewhere" was given credence as well.[58] If the trust had been a newly formed organization seeking recognition as a supporting organization, query whether the fact that the trust's support amounted to only 8 percent of Northwest's scholarship funds and affected only 9 percent of the students would have persuaded the IRS or the court that Northwest would be sufficiently attentive to the trust. Furthermore, contrast this holding with the IRS's position that the "rule of thumb" in testing attentiveness is that the supporting organization's grants must represent at least *10* percent of the supported charity's total support.[59]

Some degree of subjectivity in this analysis is unavoidable. Yet, the extent to which subjectivity affects the outcome may be ameliorated through the submission of a thorough and strong record of facts to support a conclusion that, as required by the regulations, the amount of support provided by the supporting organization is sufficient to ensure a meaningful degree of dependence by the supported charity upon the support provided by the supporting organization.

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56 *Cockerline Memorial Fund v. Commissioner*, 86 T.C. 53, at 54-55 (1986).

57 *Id.* at 61-62.

58 *Id.* at 62.

59 GCM 36379 (August 15, 1975).

Second, the "interruption" approach requires demonstration of a substantial and separately identifiable activity, and in the IRS's view, may require a showing of discontinuance.

Both the Lapham Foundation and the Cuddeback Fund argued that they supported a specific program or activity of the supported charity and that a reduction in their support would interrupt the program or activity. These arguments failed to sway the IRS or the Tax Court.

Substantial Activity. First, the court correctly noted, as specified by the regulations, that the purported program or activity must be substantial. In neither case did the court find that the organization satisfied its burden in this regard. In the *Lapham* case, the Foundation failed to convince the court that the activity in question really was a separate and identifiable program or activity. In the *Cuddeback* case, there was a clear dispute regarding the nature of the separate program or activity being supported by the Cuddeback Fund. If an organization seeking recognition as a supporting organization relies on the "interruption" approach to demonstrate attentiveness, the record should reflect that the activity supported is indeed a separately identifiable and substantial activity.

Interruption vs. Discontinuance. The IRS argued in *Cuddeback* that "interruption" of a program or activity requires its discontinuance. The court did not address this question in reaching its decision. It can be argued, though, that "interruption" should not require a showing that the program or activity would be discontinued. As discussed above, the regulations governing the integral part test seek to ensure that the supported charity is motivated to be attentive to the supporting organization. Presumably, a reduction in support for a particular program or activity that has a material impact on the program (e.g., a substantial reduction in the number of charitable beneficiaries that can be served by the program), short of requiring its discontinuance, would nonetheless motivate a supported charity to be attentive to the supporting organization.

Third, grant-making organizations may have difficulty satisfying the "but for" test.

In the *Lapham* case, the IRS argued that the "but for" test applies only in cases where the supporting organization's involvement extends beyond mere grant making. The court supported this view as well. The IRS has made this same argument in several general counsel memoranda.[60] However, in GCM 38417, which, like *Lapham*, also involved an organization seeking recognition as a supporting organization to a community trust, the IRS Chief Counsel took a different approach:

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60 *See* GCM 36523 (December 18, 1975); GCM 36379 (August 15, 1975). *See also* Internal REVENUE SERVICE CONTINUING PROFESSIONAL EDUCATION TEXT FOR FISCAL YEAR 1997, CHAPTER I., "*Public Charity Status on the Razor's Edge*."

> "The argument that grant-making is not an activity which performs the functions of or carries out the purposes of a publicly supported community trust ignores the fact that grant-making is frequently the means by which such trusts accomplish their charitable purposes. . . . Consequently, while the only activity of the supporting organization is grant-making, we do not believe that activity falls outside the scope of term 'activities' in [reg.] section 1.509(a)-4(i)(3)(ii)."[61]

However, it should be noted that in GCM 38417 the supporting organization made grants directly to the class of charitable beneficiaries that were also supported by the community trust. This distinction is clearly significant in the IRS's view. In GCM 36043, for example, two supporting organizations were operating their own scholarship programs rather than making grants to the colleges' scholarship programs. The Chief Counsel was of the view that the supporting organization was performing a function of the colleges:

> "Both the *** trusts are operating their own scholarship programs rather than simply making grants to the publicly supported organizations. Since the granting of scholarships is an accepted function of the colleges, the trusts may be considered to be performing a function of the colleges."[62]

Finally, supporting organizations to donor-advised funds can learn several lessons from the Lapham Case.

The *Lapham* case raises several interesting issues for organizations seeking recognition as supporting organizations to public charities that sponsor donor-advised funds.

The court, in holding that the Lapham Foundation satisfied the responsiveness test, noted favorably the fact that the AEF-appointed director would serve on the advisory committee of the Foundation's donor-advised fund account at AEF and would therefore have a significant voice in recommending grants. The court also noted favorably the fact that AEF exercises final authority over distributions from the Foundation's donor-advised fund account. Accordingly, the fact that the supporting organization may make only non-binding recommendations with respect to distributions from the donor-advised fund can be seen a

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61 GCM 38417 (June 20, 1980).

62 GCM 36043 (October 9, 1974). Nonetheless, the Chief Counsel was of the view that the second prong of the "but for" test was not satisfied because there was no evidence that the colleges would have engaged in the scholarship programs without the trusts.

positive factor in demonstrating satisfaction of the responsiveness test. Another positive factor is the participation by the officer or director appointed by the supported charity in making such recommendations.

In the *Lapham* case, the court stated that the "interruption" approach is available only if the supporting organization or the supported charity earmarks the support. Because the Lapham Foundation could make only non-binding recommendations with respect to its donor-advised fund account, it could not earmark its contributions. But must actual earmarking be a prerequisite to the availability of the "interruption" approach? Although it is true that the regulations state that interruption of an activity or program "may be the case" where the contributions are earmarked, this language could be interpreted as illustrative, rather than mandatory. Moreover, although a supporting organization (like any donor) may not formally earmark its contributions to a donor-advised fund, the supporting organization could in its account opening documentation commit to supporting a substantial program or activity of the supported charity. Therefore, although the supported charity retains the discretion with respect to each recommendation, the same result is achieved, from an "interruption" perspective, as if the funds had actually been earmarked.

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