

COMMUNITY FOUNDATIONS ALERT

TO: COMMUNITY FOUNDATION CLIENTS AND FRIENDS

FROM: ALSTON & BIRD LLP EXEMPT ORGANIZATIONS GROUP

DATE: MARCH 5, 2009

SUBJECT: FEES RECEIVED FOR GRANTMAKING, ADMINISTRATIVE AND CLERICAL SERVICES PROVIDED TO UNRELATED CHARITIES -- TAXABLE OR NON-TAXABLE?

Community foundations should be aware of a little-noticed but important private letter ruling recently issued by the Internal Revenue Service. The ruling (Private Letter Ruling 200832027) addresses the question of whether payments received by a community foundation for providing grantmaking, administrative, and other “back office” services to unrelated charities are subject to the unrelated business income tax (“UBIT”). The ruling contains both some good news and some bad news for community foundations on this important tax issue.

The community foundation that requested the ruling proposed to offer grantmaking and administrative support services to other grantmaking charities operating in the same community (primarily private foundations) for a fee. The proposed grantmaking services included development of grantmaking guidelines and procedures, research on potential grantees, review and evaluation of grant requests, and grants oversight. Administrative and clerical services included preparation of grant checks, fielding of day-to-day inquiries from potential grantees, and coordination of board and grant committee meetings of private foundations. The community foundation asked the IRS to rule on whether the payments it received as compensation for these services would be subject to UBIT.

In a mixed decision the IRS ruled that the grantmaking services were directly related to the community foundation's exempt charitable purposes and, therefore, that payments received for those services would not be taxed. The IRS also held, however, that the administrative and clerical services were not substantially related to the charitable purposes of the community foundation and, as a result, would generate taxable fee income.

This ruling is important because a number of community foundations have sought to capitalize on the internal expertise they have developed in the area of grants management and administration by selling this expertise to other charities, particularly smaller charities which often lack the staff and other internal resources to carry out these functions on their own. The ruling on the relatedness of the grantmaking services will come as welcome news to those community foundations -- particularly since the IRS has sometimes taken the position that a section 501(c)(3) organization's provision of services to other charities is not a related activity unless the services are provided at less than cost or some other extenuating factor is present. Although the ruling is not binding legal authority, it should provide considerable comfort to community foundations that they can provide these services without fear that the resulting fee revenue will be taxed.

On the other hand, in light of the IRS's negative ruling on the relatedness of the administrative and clerical services, community foundations which offer those types of services for a fee will need to consider whether they should either discontinue the provision of those services or begin reporting the revenues as unrelated business taxable income and paying any taxes due. Another option might be to ignore the negative ruling on the ground that it is binding only on the community foundation that requested the ruling or on the ground that that part of the ruling may be wrong.

We will be glad to discuss this ruling with you further and to answer any questions you may have. Please feel free to contact any member of Alston & Bird's Exempt Organizations Group:

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