

EXPENDITURE RESPONSIBILITY & EQUIVALENCY DETERMINATION

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**THE CENTER FOR
HIGH IMPACT PHILANTHROPY**
The University of Pennsylvania

WHEN IS AN EXPENDITURE A TAXABLE EXPENDITURE?



INTRODUCTION: TAXABLE EXPENDITURES

A grant by a private foundation to an organization other than an organization that has been classified by the IRS as a public charity will be deemed a “taxable expenditure” unless the foundation either:



(i)
exercises **expenditure responsibility** over the grant



(ii)
in the case of a foreign grantee, makes a good faith **determination that the grantee is the equivalent of a U.S. public charity.**



INTRODUCTION: TAXABLE EXPENDITURES

- Section 4945 of the Internal Revenue Code of 1986, as amended (the “Code”), imposes penalty excise taxes on a foundation that makes a taxable expenditure and on any foundation manager who knowingly approves a taxable expenditure.



- The **penalty tax is**
 - (i) for the **foundation**, **20%** of the amount of the taxable expenditure
 - (ii) for the **foundation manager**, the **lesser of 5% of the amount of the taxable expenditure or \$10,000**.
- Further penalties may be imposed if the foundation fails to take corrective action.

INTRODUCTION: TAXABLE EXPENDITURES



- Similar rules apply to sponsoring organizations of donor-advised funds.
 - Code section 4966, which defines the terms “sponsoring organization” and “donor-advised fund,” also includes the definition of “taxable distribution.”
 - The preamble to Treasury Regulations finalized in 2015 formally confirmed, for the first time, that sponsoring organizations may make equivalency determinations as an alternative to exercising expenditure responsibility.

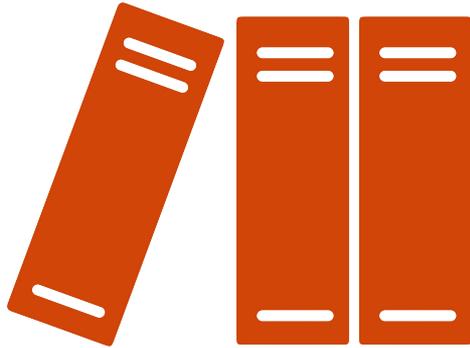


WHAT IS EXPENDITURE RESPONSIBILITY AND WHEN IS IT REQUIRED?



I. EXPENDITURE RESPONSIBILITY

A. When is Expenditure Responsibility Required?



- Private foundations and sponsoring organizations should always exert reasonable efforts and establish adequate procedures to see that grant funds are spent solely for the purposes for which they are made.



I. EXPENDITURE RESPONSIBILITY

A. When is Expenditure Responsibility Required?



- A private foundation or a sponsoring organization that fulfills the requirements of expenditure responsibility generally will not be responsible if something later goes wrong with the grant.
 - The Treasury Regulations state that a “private foundation is not an insurer of the activity of the organization to which it makes a grant.”



I. EXPENDITURE RESPONSIBILITY

A. When is Expenditure Responsibility Required?

- A grantor is not required to exercise expenditure responsibility with respect to grants to the following organizations, so long as the grants are made exclusively for charitable purposes:



1. Foreign governments



2. Agencies or instrumentalities of foreign governments



3. International organizations designated by Executive Order



I. EXPENDITURE RESPONSIBILITY

A. When is Expenditure Responsibility Required?



- Because the Treasury Regulations do not define “agency or instrumentality of a foreign government,” grantors may have difficulty determining whether a particular foreign organization qualifies.
 - If this is the case, the grantor may consider requesting an affidavit or an opinion of counsel from the foreign organization confirming that it is an agency or instrumentality of a foreign government.

WHAT IS REQUIRED UNDER EXPENDITURE RESPONSIBILITY?



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

1. **Pre-grant Inquiry**
2. **Written Grant Agreement**
3. **Reports from Grantees**
4. **Grantor Reporting and Record-Keeping Requirements**



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

1. **Pre-grant Inquiry**
2. **Written Grant Agreement**
3. **Reports from Grantees**
4. **Grantor Reporting and Record-Keeping Requirements**



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

1. Pre-grant Inquiry

- **The grantor must conduct a pre-grant inquiry concerning the potential grantee.**
- The inquiry should be complete enough to give a reasonable person assurance that the grantee will use the grant for the proper purposes.
- The inquiry should record/document matters such as:
 2. The **identity, prior history and experience** (if any), of the grantee and its managers; and
 3. Any knowledge which the grantor has (based on prior experience or otherwise), or other information which is readily available, concerning the **management, activities, and practices of the grantee.**



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

1. Pre-grant Inquiry

- A grantor should ensure that the specified purposes of the proposed grant are charitable and that there is no reason to doubt that the grantee will use the grant funds for those specified purposes.



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

1. Pre-grant Inquiry

- The scope of the inquiry may vary from case to case depending upon:
 - i. The size and purpose of the grant;
 - ii. The period over which it is to be paid; and
 - iii. The prior experience which the grantor has had with respect to the capacity of the grantee to use the grant solely for charitable purposes.

For example, if the grantee has made proper use of all prior grants to it by the grantor and provided regular reports substantiating the use of such grants, no additional pre-grant inquiry ordinarily will be necessary.



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

1. Pre-grant Inquiry
2. **Written Grant Agreement**
3. Reports from Grantees
4. Grantor Reporting and Record-Keeping Requirements



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

2. Written Grant Agreement

- i. Basic Requirements
- ii. Re-granting
- iii. The Lobbying Restriction



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

2. Written Grant Agreement

i. Basic Requirements

- The grantor must require that each grant be made subject to a written grant agreement signed by an appropriate officer, director, or trustee of the grantee.
- The grant agreement must clearly specify the purposes of the grant.

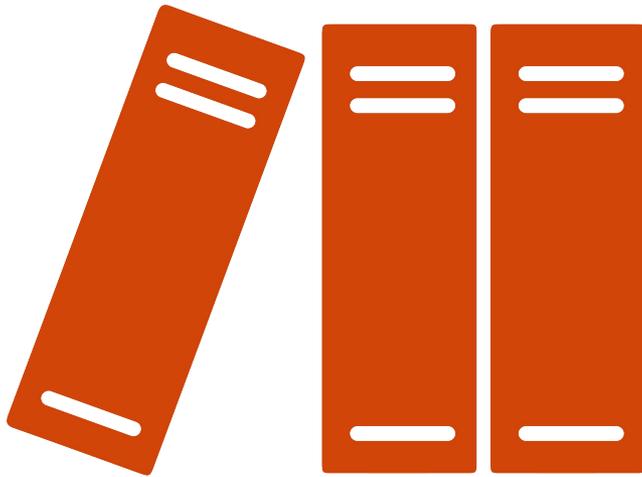


II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

2. Written Grant Agreement

- The grant agreement must include a **commitment by the grantee:**
 - To **repay any portion of the grant which is not used for the purposes of the grant;**
 - To **submit full and complete annual reports** on the manner in which the funds are spent and the progress made in accomplishing the purposes of the grant;
 - To **maintain records of receipts and expenditures** and to make its books and records available to the grantor at reasonable times



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

2. Written Grant Agreement

- The grant agreement must include a commitment by the grantee **not to use any of the funds:**



- To attempt to **influence legislation**;
- To **influence the outcome of any specific public election**, or to carry on, directly or indirectly, any **voter registration drive**;
- To **make grants to other organizations** if such grants do not also comply with the requirements of the expenditure responsibility rules;
- To **make grants to individuals**; or
- To undertake any activity **not in furtherance of charitable purposes**.

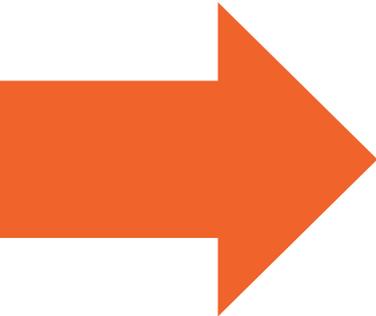


II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

2. Written Grant Agreement

- ii. Re-granting can be problematic in the expenditure responsibility context where a secondary grantee is a foreign organization.



- The expenditure responsibility rules require that the written grant agreement include a commitment by the primary grantee not to use any of the funds to make a grant to an organization if the re-grant itself does not comply with the expenditure responsibility rules.
- If the primary grantee re-grants funds to a foreign organization, it is obligated to perform expenditure responsibility with respect to that grant.



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

2. Written Grant Agreement

- The IRS has ruled that an original grantor satisfied its expenditure responsibility obligations with respect to re-granting by binding the primary grantee (a foreign organization) to meet the applicable expenditure responsibility requirements with respect to re-grants to other foreign organizations.
 - The IRS did not hold the original grantor responsible for the primary grantee's exercise of expenditure responsibility.
 - The original grantor was held responsible only for those actions within its control.



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

2. Written Grant Agreement

iii. The Lobbying Restriction



- The lobbying restriction is an area of particular confusion in applying the expenditure responsibility requirements to sponsoring organizations.
- Unlike private foundations, which are prohibited from lobbying or supporting lobbying, sponsoring organizations are public charities and are not similarly restricted.



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

2. Written Grant Agreement

- The American Bar Association Section of Taxation discussed this issue in comments submitted to the IRS on June 4, 2007, relating to the application of the Pension Protection Act of 2006 (the “PPA”) to donor-advised funds and supporting organizations (the “ABA Comments”).
 - The ABA Comments pointed out that nothing in the legislative history of Code section 4966, which was added to the Code by the PPA, suggests that the provision’s purpose was to penalize lobbying expenditures by sponsoring organizations.
 - The ABA Comments sought further guidance on this topic and recommended that the anti-lobbying restriction not be applied to grants made by sponsoring organizations.



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

2. Written Grant Agreement



- At this time, however, there is sufficient uncertainty regarding whether and how anticipated Treasury Regulations relating to sponsoring organizations will address this point, and **we generally advise our sponsoring organization clients that their expenditure responsibility grant agreements should prohibit lobbying with grant funds.**



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

1. Pre-grant Inquiry
2. Written Grant Agreement
3. Reports from Grantees
4. Grantor Reporting and Record-Keeping Requirements



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

3. Reports from Grantees

- i. Basic Requirements
- ii. Grants for Endowment, for Capital Equipment, or for Other Capital Purposes
- iii. Separate Fund Requirement



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

3. Reports from Grantees

i. Basic Requirements

- The grantor must require reports from the grantee on:
 - ✓ The use of the grant funds;
 - ✓ Compliance with the terms of the grant; and
 - ✓ The progress made by the grantee toward achieving the purposes for which the grant was made.
- The grantee must make reports at least once each year until the grant is expended in full or otherwise terminated.
- The grantee must submit the reports within a reasonable period of time after the close of the annual accounting period of the grantee for which the report is made.



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

3. Reports from Grantees

i. Basic Requirements



- We recommend that the written grant agreement set forth a schedule for annual reporting, and many of our clients also include a standard template report for use by grantees.



- Many of our clients also have set up online portals through which grantees may submit reports.



- The grantor does not need to conduct an independent verification of the grantee's reports unless it has reason to doubt their accuracy or reliability.



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

3. Reports from Grantees

ii. Grants for Endowment, for Capital Equipment, or for Other Capital Purposes

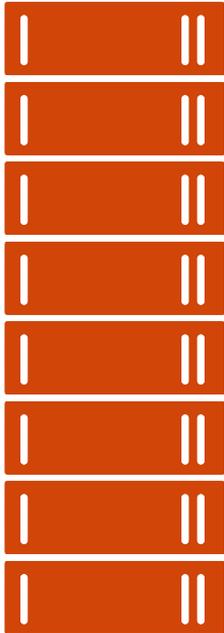
- Grants to foreign organizations for endowment, capital equipment, or other capital purposes are an area of some uncertainty.
- The Treasury Regulations provide that if a grantor makes an expenditure responsibility grant to a U.S. private foundation for endowment or capital expenditures, the grantee must make reports annually for the taxable year in which the grant was made and the immediately succeeding two taxable years, for a total of three years.
 - If the grantor is satisfied that the grant is being used for proper purposes at the end of this period, the grantee may stop making reports at the end of this three-year period.



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

3. Reports from Grantees



- No similar exception exists for expenditure responsibility grants to foreign organizations.
- Therefore, expenditure responsibility grants for endowment, for the purchase of capital equipment, or for other capital purposes to foreign organizations which do not have IRS determination letters may create difficult (and potentially indefinite) reporting burdens.
- Under a strict interpretation of the Treasury Regulations, for an endowment grant, the grantor would be required to collect reports from the grantee for the life of the endowment (which could be perpetual).



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

3. Reports from Grantees

- For capital expenditures, the Council on Foundations recommends that a grantor consider collecting reports for the “useful life” of the equipment, using generally recognized accounting principles and current U.S. tax law with respect to property and equipment capitalization.
- Because of the complexity with respect to determining the duration of reporting and recordkeeping associated with expenditure responsibility grants for endowment or capital expenditures, we generally recommend that expenditure responsibility grants not be made for these purposes.
- Instead, we recommend that grantors either make equivalency determinations in connection with such grants, or offer to fund other programs of a grantee so that it may re-allocate funds to cover its endowment or capital equipment needs.



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

3. Reports from Grantees

iii. Separate Fund Requirement

- The Treasury Regulations provide that a grantor to a foreign organization can be reasonably assured that its grant will be used exclusively for charitable purposes only if the grantee agrees continuously to maintain the grant funds in a separate fund dedicated to charitable purposes.
- Many foreign organizations are not permitted by their local banking laws to maintain more than one bank account.
 - The IRS is aware of this issue, and we believe that the IRS interprets the separate fund requirement to mean that grantees must account for grant funds separately if they are not able to hold the grant funds in a separate account.
 - Those that can hold funds in separate accounts may wish to do so for ease of reporting.



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

1. Pre-grant Inquiry
2. Written Grant Agreement
3. Reports from Grantees
4. Grantor Reporting and Record-Keeping Requirements



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

4. Reporting and Record-Keeping Requirements

- The grantor must make available to the IRS at the grantor's principal office each of the following items:
 - A copy of the written grant agreement for each expenditure responsibility grant the grantor made during the taxable year;
 - A copy of each report received during the taxable year from each such grantee; and
 - A copy of each report made by the grantor's employees or independent auditors of any audits or other investigations made during the taxable year with respect to any expenditure responsibility grant.



II. EXPENDITURE RESPONSIBILITY

B. Expenditure Responsibility Requirements

4. Reporting and Record-Keeping Requirements

- Private foundations are required to report expenditure responsibility grants on Form 990-PF.
 - At this time, the Form 990, which is filed by public charities, does not require sponsoring organizations to report expenditure responsibility grants, but it may in the future.
 - We recommend that sponsoring organizations maintain grant records in accordance with the Treasury Regulations for all expenditure responsibility grants.



I. EXPENDITURE RESPONSIBILITY

C. Violations of Expenditure Responsibility Requirements

- If a grantor determines that a grantee has used funds for improper purposes, the grantor must:
 - i. Take all reasonable and appropriate steps either:
 - To recover the grant funds; or
 - To ensure the restoration of the diverted funds and the dedication of any other grant funds held by the grantee to the purposes for which the grant was intended; and
 - ii. Withhold any further payments to the grantee until it has:
 - Received the grantee's assurances that future diversions will not occur; and
 - Required the grantee to take extraordinary precautions to prevent future diversions from occurring.



I. EXPENDITURE RESPONSIBILITY

C. Violations of Expenditure Responsibility Requirements

- If the grantee does not make the required reports, the grantor must:
 - i. Make a reasonable effort to obtain the required reports; and
 - ii. Withhold all future payments on the grant and on any other grant to the same grantee until the reports are furnished.
- In our experience, the largest single problem facing grantors making expenditure responsibility grants overseas is that grantees do not submit timely reports.
 - Some grantors have provided technical support to grantees to encourage reporting, such as setting up an online portal and/or providing email templates for submitting reports.



I. EXPENDITURE RESPONSIBILITY

D. Structuring Grants to Comply with the Requirements of Expenditure Responsibility

- i. Structuring a Grant to Give the Grantee Maximum Flexibility
- ii. Funding Overhead Expenses
- iii. Funding Capacity Building



I. EXPENDITURE RESPONSIBILITY

D. Structuring Grants to Comply with the Requirements of Expenditure Responsibility

i. Structuring a Grant to Give the Grantee Maximum Flexibility

- Because expenditure responsibility grant agreements must specify a particular charitable purpose, program, or activity, **a grantor typically cannot make general operating support grants and utilize expenditure responsibility.**
- To provide flexibility, **we recommend using a “wish-list” approach** to applications, whereby a potential grantee reviews with a grantor a wish list of items that it would like to have funded, and the grantor selects from the list in making its grant.
- The wish-list approach allows a grantor to **know specifically how any grants will be spent** and to avoid making grants that are inadvertently spend on lobbying or capital expenditures.



I. EXPENDITURE RESPONSIBILITY

D. Structuring Grants to Comply with the Requirements of Expenditure Responsibility

ii. Funding Overhead Expenses

- **The IRS does not place any restrictions on the portion of a grant that is dedicated to overhead expenses** as long as the overhead expenses further charitable purposes.
- For expenditure responsibility grants, the grantee should **spell out in detail what is included in overhead** so that the grantor knows exactly what is being funded.
 - For example, to **avoid making a grant for capital expenditures**, a grantor can work with a grantee to arrange for the grantee to lease computers rather than buy them. Or the grantor can make a grant for computer training and maintenance, rather than for the purchase of the computers.



I. EXPENDITURE RESPONSIBILITY

D. Structuring Grants to Comply with the Requirements of Expenditure Responsibility

iii. Funding Capacity Building

- Our concern with the phrase “**capacity building**,” which is a popular grant purpose, is that it is **too vague**.
- **A grantor can be comfortable making grants to fund many of the aspects of institutional capacity building, such as staff trainings or program development.**
- However, the phrase also could include activities which a grantor intending to exercise expenditure responsibility **would not want to fund**, such as **capital expenditures** or **supporting an endowment**.



I. EXPENDITURE RESPONSIBILITY

D. Structuring Grants to Comply with the Requirements of Expenditure Responsibility

- Words to watch for when reviewing a potential grantee's grant proposal or wish list:
 - Capacity building or strengthening (without further description);
 - Overhead (without further description);
 - Endowment;
 - Purchase of real estate, vehicles, or other equipment;
 - Lobbying;
 - Effective legislative engagement (though education is permitted);
 - Conduit.



I. EXPENDITURE RESPONSIBILITY

E. Additional Considerations When Making Grants to Foreign Organizations - Conduits

- In order for a U.S. taxpayer to be entitled to a charitable contribution deduction in connection with a contribution to a U.S. charity that provides funding to a foreign organization, the U.S. charity must have “discretion and control” over the use of the contribution.
 - If a U.S. charity does nothing more than transmit funds from an individual donor to a foreign organization, the IRS views the U.S. charity as a mere “conduit” and ignores the U.S. charity for purposes of determining the tax consequences of the contribution.
 - The U.S. charity is responsible for ensuring that the activities of the foreign organization further the U.S. charity’s exempt purposes.



I. EXPENDITURE RESPONSIBILITY

E. Additional Considerations When Making Grants to Foreign Organizations - Conduits

- Heightened scrutiny of grantmaking to foreign organizations is illustrated by a letter from the IRS to Greenpeace Fund, Inc. (the “Fund”) stating that changes to the Fund’s grantmaking practices were necessary to maintain the organization’s tax-exempt status.
 - The IRS warned that grant proposals to the Fund from both foreign and domestic entities were vague in terms of specific projects and the costs associated with the projects.
 - The IRS maintained that the Fund’s grant procedures were inadequate because the IRS could not review or analyze the appropriateness of particular grants or gifts.
 - Finally, the IRS asserted that failure to adequately control or ensure the appropriateness of grant and gift funds could jeopardize the Fund’s tax-exempt status.



I. EXPENDITURE RESPONSIBILITY

E. Additional Considerations When Making Grants to Foreign Organizations - Conduits

- The Department of Treasury continues to be concerned with ensuring that grants from U.S. charities to foreign organizations are used for charitable purposes.
 - The Department of Treasury issued and has updated Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities.
 - The Guidelines “are intended to assist charities in developing, re-evaluating, or strengthening a risk-based approach to guard against the threat of diversion of charitable funds or exploitation of charitable activity by terrorist organizations and their support networks.”



I. EXPENDITURE RESPONSIBILITY

E. Additional Considerations When Making Grants to Foreign Organizations - Conduits

- The heightened scrutiny surrounding grants to foreign organizations is another reason why grantors may wish to avoid making grants for general support.
- As previously discussed, where a grantor would otherwise consider making a general support grant, the grantor may consider using a “wish-list” with the potential grantee.



WHAT IS EQUIVALENCY DETERMINATION AND WHO MUST MAKE THE DETERMINATION?



III. EQUIVALENCY DETERMINATION

A. Introduction



- For a grant to a foreign organization, a private foundation grantor may avoid Code section 4945 excise taxes, without exercising expenditure responsibility, if it **determines in good faith that the foreign organization is the equivalent of a U.S. public charity.**

- A grantor will benefit from a “special rule” in the Treasury Regulations if it makes its good faith determination based on the **current, written advice of a qualified tax practitioner** that the foreign organization is the equivalent of an eligible public charity described in Code section 509(a)(1), (2) or (3).



III. EQUIVALENCY DETERMINATION

A. Introduction

- A grantor also may rely on the **“general rule” in the Treasury Regulations**, which provides that a private foundation may make an **equivalency determination without advice from a qualified tax practitioner, as long as it makes a good faith determination** that the grantee is the equivalent of U.S. public charity. However, unlike when a determination is based on advice from a qualified tax practitioner, under the “general rule,” the foundation’s determination will **not automatically be considered to be made in good faith**.
- While the Department of Treasury has not yet issued specific regulations applicable to sponsoring organizations of donor-advised funds, the preamble to final Treasury Regulations relating to equivalency determinations (the “Final Regulations”) confirmed that **sponsoring organizations may rely on the Final Regulations when making equivalency determinations**.



III. EQUIVALENCY DETERMINATION

B. Basis for Determination

- Under the Final Regulations, a grantor’s “good faith determination” generally must be based on the **current, written advice of a qualified tax practitioner**.
- Under prior law, a grantor could make a good faith determination based on a grantee **affidavit or an opinion of counsel** (of the grantor or the grantee) that the grantee is the equivalent of a public charity.
 - While the Final Regulations expanded the category of persons who may provide written advice in connection with equivalency determinations, such persons must be admitted to practice in the U.S. (i.e., grantors no longer may rely on an opinion of a grantee’s counsel, if such counsel is not admitted in the U.S.).
- As mentioned, under the Final Regulations, **grantors no longer benefit from protection under a “special rule”** when making equivalency determinations based solely on an affidavit from a grantee.
 - The Final Regulations do not foreclose reliance on a grantee affidavit. The preamble to the Final Regulations notes that a foundation manager with an understanding of U.S. tax law may rely on a grantee affidavit and make an equivalency determination under the “general rule.”



III. EQUIVALENCY DETERMINATION

C. Who Must Make the Determination?



- Under the Final Regulations, as under prior law, each U.S. **grantor must make its own independent determination** as to whether or not a foreign organization is equivalent to a U.S. public charity.
- This used to **place a costly and time-consuming burden on foreign organizations** to supply affidavits and documents to multiple U.S. organizations.
- A **trend** in recent years has been the growth of equivalency determination **“repositories”** that collect information about foreign organizations and issue current, written advice that grantors may rely upon in making an equivalency determination.
- Although the IRS has not provided explicit guidance approving the use of information from these repositories by grantors, there has been **widespread adoption and endorsement of the practice** in the field.



WHAT IS “WRITTEN ADVICE” AND WHAT ARE THE AFFILIATED REQUIREMENTS?



IV. EQUIVALENCY DETERMINATION

D. Current, Written Advice Requirements

- In making a determination that a foreign organization is equivalent to a U.S. public charity, a grantor may rely on **“current, written advice”** from a qualified tax practitioner to benefit from the “special rule.”
- Rev. Proc. 2017-53 sets forth the requirements for **“current, written advice.”**
- Written advice will be current if the facts on which the advice is based are from the **grantee’s current or prior taxable year**, meaning written advice will be **current for up to two years** after the information on which it was based is provided.
 - For grantees that must demonstrate public support, written advice will remain current for two years following the end of the five-year period over which the grantee’s public support was tested and demonstrated.



IV. EQUIVALENCY DETERMINATION

D. Current, Written Advice Requirements

- Written advice should contain sufficient facts to enable the IRS to determine that the **grantee would likely qualify as a public charity as of the date of the written advice.**
 - Factual assertions may be based on **affidavits from the grantee**, as well as a review of the **grantee's governing documents** and the laws applicable to the grantee.
- If a foundation is making a determination whether a foreign grantee is a publicly-supported organization, a foundation may rely upon a qualified tax practitioner's current, written advice that a foreign organization should be considered "**publicly supported**" for a period of two years following the five-year period upon which the qualified tax practitioner based his or her determination.
 - For example, if a foreign organization demonstrates that it should be considered publicly supported for the tax year ending December 31, 2018, based on data from 2014 – 2018, the foreign organization could be considered publicly-supported for the 2019 and 2020 tax years.



IV. EQUIVALENCY DETERMINATION

E. Foreign Organizations' Governing Documents

- When making an equivalency determination, it is critical for a qualified tax practitioner or grantor to **carefully review the foreign organization's governing documents.**
- While the governing documents do not have to include every provision that the governing documents of a U.S. public charity would include, they **cannot allow the organization to undertake material non-charitable activities.**
 - If an organization is permitted to undertake various business activities by its charter or articles, it will not be considered organized exclusively for exempt purposes.
 - Grantors may consider working with potential foreign organization grantees to amend their governing documents to comply with these requirements.



IV. EQUIVALENCY DETERMINATION

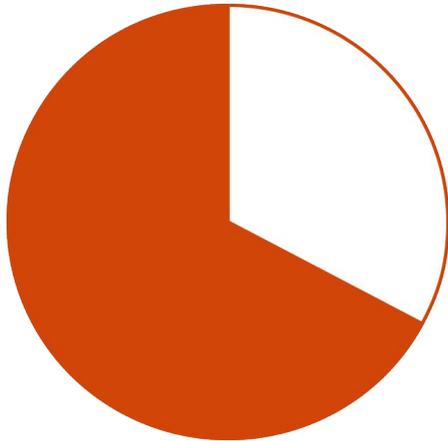
F. Laws Applicable to Foreign Organizations

- Rev. Proc. 2017-53 requires a qualified tax practitioner, in preparing the written advice, to look at the laws applicable to the foreign organization in making an equivalency determination if certain information is not contained in the grantee's governing documents.
 - This is significant because, depending on the country in which the foreign organization is located, local law may or may not include provisions necessary for a qualified tax practitioner to determine that an organization is the equivalent of a U.S. public charity.
- The Council on Foundations has assembled a resource center for global grantmaking (<http://www.cof.org/global-grantmaking/country-notes>), which includes country notes prepared by the International Center for Not-for-Profit Law for 35 countries and regions.
 - The country notes outline relevant provisions of local law that should be considered when undertaking an equivalency determination for a foreign grantee.



IV. EQUIVALENCY DETERMINATION

G. The Public Support Test



- Another concern in making an equivalency determination for a foreign organization that is not a church, school, or hospital is whether the organization will be able to **meet the public support test**.
- The public support test generally requires that an organization show that at least **one-third of its total support**, calculated on a five year rolling average, is “public support.”
- The public support calculation **can be quite complicated**, particularly for foreign organizations that are not accustomed to keeping financial records in the same manner as U.S. charities.

IV. EQUIVALENCY DETERMINATION

G. The Public Support Test

- In general, for a U.S. public charity, **public support includes:**
 - i. The full value of contributions from **U.S. governmental units**
 - ii. The full value of contributions from **U.S. public charities**
 - iii. **An amount not to exceed 2% of the organization's total support of each contribution from any other source** (including non-U.S. charities that have not received IRS determination letters).

- Rev. Proc. 2017-53 helpfully provides that **all support from foreign and domestic governmental units and public charities will count in full** towards a foreign organization's public support. This had been a question on which the field was seeking guidance for many years.



IV. EQUIVALENCY DETERMINATION

H. Foreign Schools and Nondiscriminatory Policies

- Under Rev. Proc. 92-94, which preceded Rev. Proc. 2017-53, making an equivalency determination with respect to a foreign school could be challenging because of Rev. Proc. 92-94's **requirement that foreign schools meet the same nondiscriminatory requirements required of U.S. schools** (particularly, those contained in Rev. Proc. 75-50).
- Rev. Proc. 2017-53 helpfully acknowledges that some foreign schools may have difficulty complying with certain requirements of Rev. Proc. 75-50, such as publishing notice of a racial nondiscriminatory policy in a newspaper of general circulation.
- Rev. Proc. 2017-53 relaxes those requirements somewhat by providing that, if the foreign organization is a school, a qualified tax practitioner making an equivalency determination must
 - (i) confirm the existence of a racially nondiscriminatory policy and
 - (ii) provide evidence that the school operates in a racially nondiscriminatory manner. Foreign schools need not, however, demonstrate compliance with all requirements of Rev. Proc. 75-50.



DECIDING BETWEEN ER & ED



V. ED vs ER

- An equivalency determination generally requires more time and expense before the initial grant is made, but expenditure responsibility typically involves greater reporting burdens over the period of the grant.
- An **equivalency determination** may be a more attractive option for a grantor under the following circumstances:
 - i. The grantor intends to establish a **long-term relationship** with the foreign organization.
 - ii. The grantor would like to make a grant for an **endowment or for the purchase of capital equipment**.
 - iii. The grantor would like to make a grant to a **foreign organization that intends to re-grant funds** to other foreign organizations.
 - iv. The grantor would like to **make a grant without explicitly prohibiting the use of grant funds for lobbying**.



V. ED vs ER

- Case Study: Private foundation grantor wishes to make a grant to a university in Ghana.
 - The university is unable to provide a complete schedule of public support. What are the private foundation's options?
 - The university does not publish notice of its racially non-discriminatory policy and does not keep specific records relating to compliance with its racially non-discriminatory policies. What are the private foundation's options?

- Case Study: Private foundation grantor wishes to make a grant to a religious organization in India that is operating public health programs.
 - The religious organization is a member of a larger umbrella religious organization, but its own organizing documents do not include a clause providing that, upon dissolution, its assets will be distributed for charitable purposes to other charitable entities. What are the private foundation's options?
 - The religious organization informs the private foundation that it wishes to use a portion of the grant to purchase a vehicle, which will be required to implement its public health programs. What are the private foundation's options?



V. ED vs ER

- Case Study: Sponsoring organization receives a grant recommendation for a small grant to South American charity building houses for the homeless.
 - The grant recommendation references a particular project, which does not involve capital expenditures.
 - The sponsoring organization has never made a grant to the South American charity in the past.
 - What are the relevant considerations for the sponsoring organization in determining how best to make the grant?

- Case Study: Sponsoring organization receives a grant recommendation for a multi-year project grant to a European organization where the project includes some lobbying.
 - The European organization is not able to predict exactly how much will be spend on lobbying in any individual year of the project, but the total grant is not expected to exceed the total non-lobbying expenses of the project.
 - What are the relevant considerations for the sponsoring organization? Can it exercise ER in this circumstance?



V. ED vs ER

	<u>Expenditure Responsibility</u>	<u>Equivalency Determination</u>
Endowment/ Capital Expenditures	<p>For an endowment grant, the grantor would be required to collect reports from the grantee for the life of the endowment (which could be perpetual).</p> <p>For capital expenditures, the Council on Foundations recommends that a grantor consider collecting reports for the “useful life” of the equipment, using generally recognized accounting principles and current U.S. law regarding property and equipment capitalization.</p>	<p>No similar requirement applies. The grantor should make its own judgment as to how long it will ask the grantee to submit reports.</p>
Re-granting	<p>The grant agreement must bind the primary grantee to exercise expenditure responsibility over a grant to any secondary grantee that is not a U.S. public charity.</p>	<p>No similar requirement applies. However, especially in the context of grants to foreign organizations, the grantor should know if the primary grantee intends to re-grant funds, and if so, the identities of any secondary grantees.</p>
Lobbying	<p>The grant agreement must state that grant funds may not be used for lobbying.</p>	<p>The grant agreement is not required explicitly to exclude the use of the funds for lobbying.</p>
Separate Fund	<p>The grantee is required to keep grant funds in a separate account, or at least separately account for grant funds if the grantee is not able to open more than one bank account.</p>	<p>No similar requirement applies.</p>



THANK YOU!

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