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Internal Revenue Service

OP:E:EO:T:4

Department of the Treasury

200010056

Washington, DC 20224

Contact Person:

Telephone Number:

In Reference to:

Date:
DEC 14 1999

Legend:

B=
C=
D=

Dear Sir or Madam:

This is in reference to your letter of September 10, 1999, requesting certain rulings with regard to modification of B's grant program.

B is exempt under section 501(c)(3) of the Code and is classified as a private foundation under section 509(a).

B was funded by D which is substantial contributor and disqualified person with respect to B under section 4946 of the Code. D works closely with B to fund, from B assets, deserving charitable projects in those areas where D has a presence or interest. D performs a number of functions in the solicitation and review of grant proposals at no charge to B. Through its many employees worldwide and building upon its strong history as a community leader and supporter of philanthropy, D is able to enrich the charitable grantmaking of B to a degree which could not otherwise be possible with existing B resources.

B is proposing to modify its C program to begin making charitable grants to smaller foreign charitable organizations. Under the program C accepts grant applications in the amount of one dollar to one million dollars. The C program does not have any specific grant application form, but does require that the grant proposal be less than five single-spaced pages.

Neither D nor any D employee is permitted to obtain any personal benefit from the grants. Funds from the grants cannot be used to purchase any goods or services from D.

As contemplated under the program, the Chief Officer of the foreign charity applicant submits an application. If available, the foreign charity includes an Affidavit for Equivalency

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Determination which complies with section 53.4945-5(a)(5) of the regulations and Rev. Proc. 92-94, 1992-2 C.B. 507. For those organizations that do not furnish an Affidavit for Equivalency Determination, the grant approval board will require "expenditure responsibility" with respect to the grant. A designated employee of D will be involved in monitoring the grant.

In many foreign countries, the need for charitable support is great and the charitable benefits produced by what would be considered even modest grants here in the United States are often dramatic. However, in many of these same countries, the charitable regulatory infrastructure that is common in the United States does not exist. The lack of such an infrastructure complicates compliance with U.S. tax laws. Accordingly, rather than reject many such grant applications out of hand, B desires to exercise expenditure responsibility as appropriate.

The exercise of expenditure responsibility in such cases is quite challenging and B has already taken into account many of these concerns. For example, in some foreign countries where grants would be made, the foreign charitable organization may not have a bank account and the local banking environment may be quite primitive. In other situations, making requests directly to external suppliers, such as contractors, may carry with it the taint of "corruption" or disguised "kickbacks". In both these cases, grant payments will be made directly to the foreign charity. In cases where the economic environment is more stable, B will consider the recommendation of D's employee(s) and make payments directly to the foreign service or equipment supplier.

D's designated employee involvement is crucial in investigating the legitimacy of the foreign charity and its programs. D's employee is aware of local cultural norms and is attuned to the needs of B to avoid the appearance of corruption or impropriety.

The proposed written grant commitment for grants from B under the C program includes an agreement by the grantee to repay any portion of the grant not used for grant purposes; 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; and not to use any of the funds; to carry on propaganda, or otherwise 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 any grant which does not comply with the individual grant

requirement of section 4945(d)(3) of the Code or the organization grant requirements of section 4945(d)(4); or, to undertake any activity for any noncharitable purpose. The written agreement also specifies the purposes of the grant.

B will retain records indicating the following: the name and address of the grantee; the date and amount of the grant; the purpose of the grant; the amounts spent by the grantee (based upon the most recent report received from the grantee); whether the grantee has diverted any portion of the funds (or the income therefrom in the case of an endowment grant) from the purpose of the grant (to the knowledge or the grantor); the dates of any reports received from the grantee; and, the date and results of any verification of the grantee's reports.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable and educational purposes.

Section 509(a)(1) of the Code defines private foundation as a domestic or foreign organization described in section 501(c)(3) other than an organization described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)).

Section 4942 of the Code imposes an excise tax on a private foundation unless the foundation annually makes qualifying distributions equal to at least 5% of the fair market value of its assets.

Section 4942(g)(1) of the Code provides that the term "qualifying distributions" means any amount paid to accomplish one or more of the charitable purposes described in section 170(c)(2)(B) other than contributions to a controlled organization or a private nonoperating foundation.

Section 53.4942(a)-3(a)(6) of the Foundation and Similar Excise Taxes Regulations provides that if a distribution is to a foreign organization which does not have a ruling or determination letter from the Internal Revenue Service stating that it is an organization described in section 509(a)(1), (2) or (3)of the Code, then the grantor private foundation may make a good faith determination that the grantee organization is an organization described in section 509(a)(1), (2) or (3) of the Code.

Section 4945 of the Code provides for the imposition of taxes on each taxable expenditure of a private foundation.

Section 4945(d)(4) of the Code requires that any amount paid by a private foundation to any organization (other than a public charity) will be deemed a taxable expenditure unless the private foundation exercises expenditure responsibility.

Section 4945(h) of the Code provides that the expenditure responsibility referred to in subsection (d)(4) means that the private foundation is responsible to exert all reasonable efforts and to establish adequate procedures to see that the grant is spent solely for the purpose for which made; to obtain full and complete records from the grantee on how the funds are spent; and, to make full and detailed reports with respect to such expenditures to the Secretary.

Section 53.4945-5(b) of the regulations provides that a private foundation will be deemed to be exercising expenditure responsibility with respect to a grant where it conducts a pre-grant inquiry to obtain reasonable assurance that the grantee of the funds will use them for the proper purposes. Moreover, section 53.4945-5(b)(3) of the regulations requires the grantee to execute a written agreement specifying the purposes of the grant and promising to use all of the funds received from the private foundation for the purposes stated in the agreement and to return all funds not so used; to submit a full and complete financial report to the private foundation once a year; to maintain adequate books and records to be made available for inspection by the private foundation; and not to use any of the funds to influence legislation, carry on propaganda or participate in political elections.

Section 53.4945-6(c)(1) of the regulations provides that a private foundation may not make a grant to an organization not described in section 501(c)(3) unless the making of the grant itself constitutes a direct charitable act or a program related investment; or through compliance with section 53.4945-6(c)(2) of the regulations, the grantor is "reasonably assured" that the grant will be used for purposes described in section 170(c)(2)(B) of the Code. Section 170(c)(2)(B) of the Code specifies purposes including religious, charitable, scientific and educational.

Section 53.4945-6(c)(2) of the regulations provides that a private foundation may be "reasonably assured" that the grant will be used for purposes under section 170(c)(2)(B) of the Code only if the grantee agrees and subsequently does maintain the funds in a separate fund dedicated to purposes described under section 170(c)(2)(B) of the Code.

Section 53.4945-5(a)(5) of the regulations provides that if a private foundation makes a grant to a foreign organization

which does not have a ruling or determination letter from the Internal Revenue Service stating that it is an organization described in section 509(a)(1), (2) or (3) of the Code, such grant will not be treated as a grant made to an organization other than an organization described in section 509(a)(1),(2) or (3) of the Code if the grantor private foundation has made a good faith determination that the grantee organization is an organization described in section 509(a)(1), (2) or (3) of the Code. Such a "good faith determination" ordinarily will be considered as made where the determination is based on an affidavit of the grantee organization or an opinion of counsel of the grantor or the grantee that the grantee is an organization described in section 509(a)(1), (2) or (3) of the Code. Such an affidavit or opinion must set forth sufficient facts concerning the operations and support of the grantee to enable the Internal Revenue Service to determine that the grantee would likely qualify as an organization described in section 509(a)(1), (2), or (3) of the Code.

Rev. Proc. 92-94, 1992-2 C.B. 507, describes a safe harbor process by which a private foundation manager can exercise reasonable judgment under section 4945(d) of the Code concerning a grant to a foreign grantee organization that lacks a determination letter from the Internal Revenue Service that it is exempt under section 501(c)(3) and is not a private foundation under section 509(a)(1), (2) or (3) of the Code.

Section 5.04 of Rev. Proc. 92-94 provides that, before making a grant to a foreign grantee organization that has no Internal Revenue Service determination letter as to its status under sections 501(c)(3) and 509(a)(1) of the Code, the grantor foundation can obtain an affidavit, signed by an grantee officer, explaining that the grantee is organized and operated for such exempt purposes. The grantee's affidavit must include a description or its activities, a copy of its organizing documents, and information to show its dedication of income and assets to exempt purposes, its lack of any proprietary or private interests, its dissolution only for exempt purposes, its lack of more than insubstantial influencing of legislation, its lack of participation in any political campaigns, its absence of control by any other organization for any nonexempt purposes, and its financial data as to any relevant public financial support.

Rev. Rul. 71-460, 1971-2 C.B. 231 holds that an activity which is charitable within the meaning of section 501(c)(3), if carried on in the United States, would also be a charitable activity if carried on in foreign country.

Based upon the above facts, we have determined that the distributions under the C program will be qualifying distributions by B under section 4942(g) of the Code. The information submitted indicates that the grants from B to the foreign charities are intended to be used to accomplish one or more of the charitable purposes described in section 170(c)(2)(B), and are not contributions to a controlled organization or a private nonoperating foundation. That the charitable activity of B will be conducted in a foreign country does not change the fact that these grants are considered to be qualifying distributions. Rev. Rul. 71-460, 1971-2 C.B. 231, specifically holds that an activity which is charitable within the meaning of section 501(c)(3), if carried on in the United States, would also be a charitable activity if carried on in a foreign country. Moreover, the information provided indicates that B will have in place guidelines and measures which will allow B to be reasonably assured that the grants will be used by the foreign charity for charitable purposes within the meaning of sections 501(c)(3) and 170(c)(2)(B) of the Code.

We have also determined that the distributions under the C program will not be taxable expenditures by B under section 4945(d) of the Code. The information submitted indicates that B has taken adequate steps to ensure that the grants will be used by these foreign charities for their intended charitable purpose. First, under B's guidelines and procedures, where the foreign charity can avail itself of the equivalency letter process, the foreign charity is required to do so, and must satisfy the requirements set forth in sections 53.4945-5(a)(5) of the regulations and Rev. Proc. 92-94. Second, if the foreign charities cannot avail themselves of the "qualified affidavit" procedure under Rev. Rul. 92-94, then B will exercise expenditure responsibility in accordance with the terms of C's program guidelines and procedures. C's program guidelines and procedures require that these foreign charities provide specific information through the grant application and the grant agreement which allows B to exercise the requisite expenditure responsibility as required under section 53.4945-5(b) of the regulations.

Accordingly, based on the information furnished, we rule as follows:

1. Distributions under the C program will be qualifying distributions by B under section 4942(g) of the Code.

2. Distributions under the C program will not be taxable expenditures by B under section 4945(d) of the Code.

We are informing the TE/GE office of this action. Please keep a copy of this ruling with your permanent records.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Group 4