COUNCIL *on* FOUNDATIONS

May 16, 2016

Via Electronic Delivery

Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2016-26)
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

RE: **Recommendations for 2016-2017 Priority Guidance Plan Notice 2016-26**

Dear Ladies and Gentlemen:

The Council on Foundations believes that updated guidance from Treasury on the matters set forth in our letter of May 1, 2015, some of which are reiterated here along with a few new requests, is of increasing importance to international philanthropy. The members of the Council are concerned that the continued absence of guidance is having a negative impact on the ability of U.S. grantmaking organizations to ensure that their operations are in full compliance with the requirements of the law. To that end, we again offer our recommendations with regard to the Priority Guidance Plan.

Pursuant to the request for comments published in Notice 2016-26, I write to urge the Internal Revenue Service and the Department of the Treasury's Office of Tax Policy to include in their 2015-16 Priority Guidance Plan an update to Revenue Procedure 92-94.[1] We appreciate that Treasury has already indicated its commitment to updating the Revenue Procedure, and we ask that this be included as a priority for 2016.

Revenue Procedure 92-94 currently sets forth acceptable procedures for grantmakers to follow in making "equivalency determinations" determining the U.S. tax classification of their foreign grantees. We thank Treasury for its guidance on relying on equivalency determination opinions by qualified tax professionals,[2] which is significantly reducing burdens on foreign grantmaking. However, because Revenue Procedure 92-94 is still the only authoritative guidance about the substance of the equivalency determination process, it is important for it to be updated in order to resolve potential controversy over its application given intervening changes in the law, and to resolve various longstanding questions about the application of U.S. rules to foreign organizations.

[1] 1992-1 C.B. 507.
[2] Reliance Standards for Making Good Faith Determinations, 80 Fed. Reg. 24346 (September 25, 2015) (amending Treas. Reg. §§ 53.4942(a)-(3)(a)(6) and 53.4945-5(a)(5)).

We would also recommend that Treasury and the IRS update their guidance relating to grants to Mexican charities under the U.S.-Mexico Income Tax Convention (the "Treaty") in light of changes to Mexican law, in order to identify the core set of Mexican charities under Mexican law that can continue to be treated as eligible for benefits under the Treaty.

Finally, we request that the IRS modify the definition of "withholdable payment" under the Foreign Account Tax Compliance Act (FATCA) to include grants from Section 501(c) organizations on the list of nonfinancial payments not treated as withholdable payments, as scholarships, prizes, awards, and payments for services are listed currently.

Suggested Updates to Revenue Procedure 92-94

For over twenty years, Revenue Procedure 92-94 has been the primary source of guidance for grantmakers about the type of information that should be gathered in order to support an equivalency determination. Setting forth this information in a revenue procedure has been important because it has allowed the IRS to maintain a general good faith standard in the regulations that is flexible enough to be applied case by case to the endless variety of situations confronting international grantmakers, while still prescribing a relatively clear model package of information that grantmakers should obtain (and which grantmakers are encouraged to obtain in order to qualify for its safe harbor). Prior to the advent of Revenue Procedure 92-94, many grantmakers were discouraged from participating in international philanthropy because they were not sure what kind of information the IRS might, in a retrospective audit, decide that they should have obtained as a basis for their equivalency determinations. Revenue Procedure 92-94 quieted those concerns while having a powerful effect as a standard-setting document.

However, despite its critical role, Revenue Procedure 92-94 is showing its age. A significant amount of friction in international grantmaking could be avoided with additional clarifications surrounding a few questions commonly affecting equivalency determinations. Many of these issues have been raised previously as subjects ripe for clarification by the Council on Foundations, TechSoup Global, the Tax Section of the American Bar Association, leading private foundations, and by the Advisory Committee for Tax-Exempt and Government Entities. [3] In most cases, the wording changes necessary to make these clarifications are quite simple. An update to Revenue Procedure 92-94 addressing these issues should be placed on the Priority Guidance Plan for 2016-17.

Without restating the full rationale for all of the changes that have been repeatedly proposed over the years, the principal corrections and changes we would recommend may be summarized as follows:

- **New Organizations.** Allow a grantmaker conducting an equivalency determination to apply current law to determine whether a new organization will meet the applicable

[3] *See* Letter from Steve Gunderson, President, Council on Foundations to Michael Mundaca, Acting Assistant Secretary for Tax Policy, Department of the Treasury (Dec. 28, 2009); Letter from Michael Hirschfeld on behalf of the American Bar Association Section of Taxation to Daniel Werfel, Acting Commissioner of the IRS (Aug, 14, 2013), 2013 Tax Notes Today 158–18; Advisory Committee on Tax-Exempt and Government Entities, *Exempt Organizations: Recommendations to Improve the Tax Rules Governing International Grantmaking* 14-20 (2009).

public support test under Sections 170(b)(1)(A)(vi) or 509(a)(2), specifically to determine whether there is a "reasonable expectation" that the organization will meet the relevant test at the end of the organization's first five years of existence.[4]

- **Equivalency for international organizations, foreign government instrumentalities, etc.** Confirm that a grantmaker can also make a good faith determination that a grantee is an international organization, foreign government instrumentality, foreign public university, or other entity treated as a public charity under Treasury Regulations Section 53.4945-5(a)(4).

- **Public support from certain foreign governments and public charities.** Clarify that a grantmaker evaluating the public support of a foreign organization may treat as 100 percent public support under the Section 170(b)(1)(A)(vi) test all support from other foreign charities meeting that public support test or from the United Nations, foreign governments, foreign government instrumentalities, and foreign public universities, as would be the case for funding received from a domestic government entity or Section 170(b)(1)(A)(vi) public charity.[5]

- **No requirement to restrict lobbying in governing documents.** Make clear that foreign organizations that do not engage in political campaign intervention or substantial lobbying activities and that do not have governing documents expressly empowering them to do so comply with Section 501(c)(3), even if they are not expressly forbidden from engaging in these activities under their governing documents or local law.

- **Application of Nondiscrimination Requirement to Foreign Schools.** Remove the requirement that a foreign educational institution must comply with the specific procedures for publicizing its nondiscrimination policy set forth in Revenue Procedure 75-50[6] (or provide an account of why it has not, which must then be evaluated by the grantmaker). We agree that educational institutions should continue to attest that they operate according to a policy of nondiscrimination, but believe it is unreasonable to expect foreign organizations that may have different national histories regarding racial discrimination to know about and comply with these U.S.-specific requirements. In the vast majority of cases, we do not believe that mere noncompliance with these specific procedures would warrant a finding that an otherwise qualified educational institution is operating in violation of public policy and thus ineligible for Section 501(c)(3) status.

[4] *See* Treas. Reg. § 1.170A-9(f)(4)(v); Treas. Reg. § 1.509(a)-3(d)(1).
[5] *See* Treas. Reg. § 1.509(a)-2(a)(2); Rev. Rul. 75-435, 1975-2 C.B. 215 (treating grants from foreign governments to a foreign charity as includable in public support without limitation).
[6] 1975-2 C.B. 587.

- **Application of Section 501(r) to foreign hospitals.** Conform Revenue Procedure 92-94 to current law, which makes clear that Section 501(r) does not apply to foreign hospitals.[7]

- **Electronic Data Collection.** To enable electronic collection of equivalency information, clarify that a physically signed affidavit is not essential.

- **Use of third-party materials.** Clarify that grantmakers may rely on translations and public information about foreign laws from other sources besides the foreign organization under review, as well as on nonprofit-provided affidavits that the grantmaker does not receive directly from the foreign nonprofit organization.

As noted above, we commend Treasury and the IRS for issuing proposed changes to Treasury Regulations Sections 53.4942(a)-3(a)(6) and 53.4945-5(a)(5) (the "Proposed Regulations"), which govern reliance standards for making good faith determinations regarding whether a foreign grantee is the equivalent of a U.S. public charity. We appreciate that guidance and acknowledge that the new regulations are already reducing barriers to international grantmaking, particularly by enabling the charitable sector to develop vehicles such as equivalency determination repositories.

However, it is still necessary to address the sector's other requests for clarification of Revenue Procedure 92-94. Simply put, the Proposed Regulations provide helpful clarifications expanding the universe of third-party professionals upon whose judgment grantmakers can rely, but they do not address the substantive standards that grantmakers and professionals should apply in determining how much information to gather from grantees or how to evaluate that information once it is obtained. Accordingly, we believe that the need for the model affidavit and safe harbor provided in Revenue Procedure 92-94 is no less necessary now than it was prior to the release of the Proposed Regulations. We therefore urge the IRS to make the substantive corrections and clarifications discussed above.

Request for Updated Guidance under the U.S.–Mexico Income Tax Convention

Under Article 22 of the U.S.–Mexico Income Tax Convention (the "Treaty"), and Article 17 of the Protocol to that convention, the U.S. and Mexico have agreed that certain Mexican charities meeting standards "essentially equivalent" to those applicable to U.S. public charities (originally those described in Article 70–B of the Mexican Income Tax Law) would be treated as public charities for purposes of grants from U.S. public charities and private foundations. Such Mexican charities are also exempt from U.S. income taxes to the same extent as their U.S. counterparts, and charitable contributions to such Mexican charities are eligible for U.S. income tax deductions (subject to some limitations).

In Information Letter 2003-158 (Sept. 30, 2003), the IRS confirmed that U.S. grantmakers could rely on the Mexican Ministry of Finance and Public Credit's determination of Article 70–B

[7] *See* 77 Fed. Reg. 38150. *See also* Prop. Reg. §§ 1.501(r)-1(b)(15).

status, set forth either in a letter from that agency providing special authorization under Article 70–B, or reflected in the current official list of Mexican charities published in the Mexican *Official Gazette* (*el diario official de la Federacion*). That guidance, however, is now out of date. Mexico has renumbered its income tax provisions a few times since ratification of the Treaty; for more than a decade, former Article 70–B has been found in Article 97. However, it was moved to Article 82 of a Mexican Income Tax Law that took effect January 1, 2014, which also contains provisions governing other types of charities. There have been some minor substantive changes made to Article 97 at various points over the past few years, and the new law includes additional changes (particularly regarding activities influencing legislation), although the core requirements (to be organized and operated exclusively for exempt purposes, to avoid private inurement, to have a valid dissolution clause, etc.) are still in place.

For the past several years, the most current version of the list of Mexican charities eligible to receive tax-deductible contributions has been available online at http://www.sat.gob.mx/terceros_autorizados/donatarias_donaciones/Paginas/directorio_donatarias.aspx. Those organizations qualifying for treaty benefits have been specially designated as type "L" organizations; the list expressly states that such organizations meet not only the requirements of former Article 97, but also the provisions previously in Article 70–B (which carried over into Article 97 when it was renumbered). We do not yet know how these listings, and the ability to rely on them, have been affected by the 2014 statutory changes.

Until 2014, private foundations and other donors could generally rely on the Mexican authorities' determination that an organization qualified under Article 97 and former Article 70–B to treat it as a public charity. However, the recent changes will inhibit many grantmakers from relying on the Mexican Treaty until Treasury and the IRS provide clear guidance about how it applies to the new Mexican Income Tax Law. We would specifically request that Treasury, consulting with the Mexican government as necessary, do the following:

- Identify the class of Mexican charities that will be treated as "essentially equivalent" to Sections 509(a)(1) and 509(a)(2) public charities under the new Mexican Income Tax Law in effect as of January 1, 2014, and provide updated information as to the documentation upon which U.S. grantmakers can rely for purposes of determining status of a Mexican organization under the Treaty.

- Confirm that under Article 2(4) of the Treaty, Section 4966's excise tax is a subsequently added excise tax "identical or substantially similar" to Section 4945, and that donor advised funds can therefore rely on the Treaty to the same extent as private foundations and other public charities.

- In the interim, provide transition relief allowing U.S. grantmakers to continue to rely on determination letters confirming status under former Article 97, at least with respect to grants committed before the change in Mexican law.

Some of this guidance could be provided as part of an update of Revenue Procedure 92-94, or it could be separated out, given its potential applicability to individual donors or to determining the tax-exempt status of qualifying Mexican organizations from U.S. income taxes.

Recently, the Council has also become aware of issues arising from Mexico's anti-money laundering and anti-terrorist financing rules that are causing considerable confusion among U.S. grantmakers and are having an impact on the grantmaking authorized by the Treaty. Public statements by officials from the Treasury financial crimes enforcement agency, FinCEN, indicate that there has been coordination between Mexico and FinCEN on various enforcement matters.[8] Many of the concerns of our members arise from confusion regarding the nature and extent of information that U.S. grantmakers must provide to the Unidad de Inteligencia Financiera ("UIF"), particularly personal identifying information. Given the impact of the rules on Treaty-authorized grantmaking, we ask that Treasury consider raising the need for greater clarity in the reporting obligation when it discusses the Treaty issues with Mexico noted above.

Request for Expansion of FATCA Exemption to Include Charitable Grants

July 1, 2014 marked the start of implementation of many provisions of the Foreign Account Tax Compliance Act of 2010 (FATCA),[9] a major legislative effort to force additional reporting by offshore financial institutions and other foreign entities about the extent to which investment income they receive is attributable to U.S. persons, thus making it more difficult for U.S. persons to evade tax by hiding assets in offshore accounts.

In many cases, the regime now requires U.S. institutions paying "withholdable payments" to foreign persons to have those foreign persons fill out a certificate selecting their appropriate status under FATCA's rules, choosing from a dizzying array of options such as "Active NFFE," "Excepted Nonfinancial Group Entity," "Owner-Documented FFI," and "Entity Wholly Owned by Exempt Beneficial Owners," and usually then being required to make detailed certifications confirming that it meets the conditions for that status.[10] Foreign grantees might be able to qualify as "501(c) Organizations," but that requires either an IRS letter or an opinion of counsel confirming that status, or certification as a "Nonprofit Organization" confirming that the organization is tax-exempt, restricted to charitable purposes, and meets various other requirements under local law.[11] Depending on the recipient's classification, withholding or reporting on the payment may be required, or more information about the ownership of the entity might have to be disclosed.[12]

FATCA is aimed at requiring increased disclosure primarily in the context of financial institutions and other entities making payments of investment income or similar financial payments. The regulations under FATCA have provided clear exemptions from the definition of "withholdable payment" for certain nonfinancial payments, including the following:

- Compensation for services;

[8] *See, e.g.* FinCEN and Mexican Counterpart Shine Spotlight on Cross-Border Cash Couriers, FinCEN Press Release, August 1, 2014, and Jennifer Shasky Calvery, Director, Financial Crimes Enforcement Network, remarks to the *Mexican Bankers Association AML/CFT Seminar,* October 3, 2014.

[9] Pub. L. No. 111–147, 124 Stat. 97 (2010).
[10] *See* IRS Form W-8BEN-E (revised Feb. 2014), *available at* http://www.irs.gov/pub/irs-pdf/fw8bene.pdf
[11] *See id*.
[12] *See* I.R.C. §§ 1471, 1472; Treas. Reg. § 1.1471-1, -1T.

- Payments for the use of property;
- Office and equipment leases;
- Software licenses;
- Transportation and freight payments;
- Gambling winnings; and
- Awards, prizes, and scholarships.[13]

Thus, those making such payments are not subject to the extra complications of the FATCA regime.

We believe that grants from Section 501(c) organizations, whether to individuals or to entities, are of a similar nature to prizes, scholarships, and awards, or in some cases to payments of compensation (in the case of grants for the accomplishment of a specific project). If these payments are excluded from the FATCA regime, grants from U.S. tax-exempt organizations should also be excluded. Like these other payments, a grant is simply not a kind of income likely to be earned by a foreign account holding assets hidden offshore by private U.S. taxpayers. It is therefore not a financial industry transaction of the sort at which FATCA was aimed, and deserves to be classified with them as a "nonfinancial payment."

Relief is especially warranted because U.S. grantmakers and foreign grantees may be financially unsophisticated nonprofit organizations ill-equipped to deal with the complexities of the new FATCA regime. Forcing them to put in place the document collection and reporting systems to comply with FATCA potentially adds a whole new level of bureaucracy to cross-border grantmaking beyond equivalency determination or expenditure responsibility, without meaningfully impacting disclosure of private U.S. taxpayers hiding income-producing assets in foreign accounts.[14] Furthermore, we see little justification for a rule that would make a foundation's service contract payments to foreign vendors, but not grants to foreign grantees for charitable work, exempt from the FATCA regime. Such an asymmetry would create perverse incentives for U.S. charities to structure their payments to foreign persons for charitable work as contracts for services rather than as grants.

Accordingly, we recommend that Treasury adjust FATCA to make the following changes:

[13] Treas. Reg. § 1.1473-1(a)(4)(iii).

[14] We recognize that many grants are already excluded from the definition of "withholdable payment" because they are not U.S.-source taxable income to the recipient, either because they are not considered U.S.-source income under Treasury Regulation § 1.863-1(d) or because they are excludable from income as gifts or under other provisions of the Code. *See, e.g.*, Priv. Ltr. Rul. 200529004 (July 22, 2005) (holding that a charitable grant to a foreign nonprofit entity was not income because it was a gift under section 102). However, that only strengthens the argument for not requiring FATCA compliance in the remaining cases, so that grantmakers do not have to build out elaborate grantee processing systems to deal with those grants that for some reason fail to qualify for these exceptions. For instance, it is not infrequent for a large grant for a project in a foreign country to include some funding for a small amount of activity in the United States, thus making part of the grant U.S.-source and subject to FATCA withholding unless another exception applies. This requires the grantmaker to parse through the complicated rules for collecting information and reporting it under FATCA because of a relatively minor portion of a much larger grant.

- Amend Treasury Regulation Section 1.1473-1(a)(4) or the corresponding temporary and proposed regulations to remove grants from Section 501(c) organizations from the definition of "withholdable payment."

- Confirm that grantmakers may use a version of the Form W-8BEN that does not require determination of Chapter 4 (i.e., FATCA) status for grant payments and similar payments excluded from the definition of withholdable payment.

Conclusion

In sum, and in accordance with the above, we strongly urge the Department of Treasury to act swiftly to update Revenue Procedure 92-94. We also ask that it update its guidance regarding application of the Mexican Treaty and take the steps outlined above to keep FATCA from imposing significant additional regulatory burdens on cross-border philanthropy. Each of these items deserves a place on the Treasury Department's 2016-2017 Priority Guidance Plan. Updated guidance will be of significant assistance to the philanthropic sector and also to the IRS, which has expressed concerns to the Government Accountability Office regarding the "overseas activities" of some tax-exempt organizations.[15]

Thank you for your attention to this matter. We would welcome the opportunity to discuss any of these matters with the IRS or with the Department of Treasury if it would be helpful. In particular, the Council offers its support for convening more informal discussions of the compliance issues faced by U.S. grantmakers regarding grants to charities in Mexico. It is possible that an exchange that included representatives of both governments and the philanthropic sector in both countries could point the way to clearer, more effective and more efficient guidance on the important philanthropic relationship between the two nations.

Sincerely,

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[15] *See* United States Government Accountability Office Report to the Ranking Member, Committee on Homeland Security and Governmental Affairs, U. S, Senate, *Tax-Exempt Organizations, Better Compliance Indicators and Data, and More Collaboration with State Regulators Would Strengthen Oversight of Charitable Organizations,* December 2014, GAO-15-164.

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