



COUNCIL *on* FOUNDATIONS

December 28, 2009

**Via Federal Express and Facsimile**

Michael Mundaca, Esq.  
Acting Assistant Secretary for Tax Policy  
Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, D.C. 20220

**Re: Proposed Revisions to Revenue Procedure 92-94**

Dear Mr. Mundaca:

We are writing on behalf of the Council on Foundations and a coalition of major United States grantmakers to request an update to Revenue Procedure 92-94,<sup>1</sup> the Treasury Department's primary guidance on the "equivalency determination" ("ED") process. In particular, we urge Treasury to amend Revenue Procedure 92-94 to implement the recommendations of the Advisory Committee for Tax Exempt and Governmental Entities by authorizing the creation of equivalency determination information repositories ("EDIRs") that can make equivalency determinations on which third parties can rely, as well as by clarifying various aspects of the substantive standards to be applied in the equivalency determination context.<sup>2</sup> In addition to the benefits such changes would produce for U.S. grantmakers, centralizing the ED process in specialized, IRS-reviewed bodies should be a key part of ongoing efforts by the IRS and Treasury to ensure that charitable grants abroad are used exclusively for exempt purposes.

Furthermore, intervening changes in the law (notably, Treasury's September 2008 temporary regulations governing public support calculations<sup>3</sup>) make it imperative to bring Revenue Procedure 92-94 into conformity with current law as soon as possible in order to avoid

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<sup>1</sup> 1992-1 C.B. 507.

<sup>2</sup> Advisory Committee on Tax-Exempt and Governmental Entities, *Exempt Organizations: Recommendations to Improve the Tax Rules Governing International Grantmaking* 11-14 (2009) [hereinafter "Advisory Committee Report"]. A copy of this report is enclosed for your reference.

<sup>3</sup> T.D. 9423 (Sept. 8, 2008).

any question about grantmakers' ability to rely on it. We have enclosed proposed revisions to that revenue procedure in hopes that they will facilitate your consideration of these matters. Of course, we would welcome the chance to speak with you about the specifics of the attached revisions, or about the larger policies they are meant to implement.

### **I. The Need for Equivalency Determination Information Repositories**

The charitable needs addressed by U.S. philanthropy are global. U.S. grantmakers are now called upon to address crises of hunger, disease, illiteracy, environmental degradation, and other compelling human needs around the world. These are serious problems with global effects, and many U.S. grantmakers have recognized that in the long run we in the United States cannot afford to overlook these problems simply because their most severe immediate effects occur outside our borders. As a result, U.S. grantmakers invest a growing amount of time and resources to further charitable causes in other countries. A Foundation Center 2008 International Grantmaking Report estimates that the nation's 72,000 grantmaking foundations gave an estimated \$5.4 billion in 2007 for international causes. The report noted that this figure constituted a 70% increase over five years. Clearly, this is a growing area in which effective guidance will be increasingly important—both in order to reduce the burdens on legitimate activity and in order to curtail possibilities for abuse.

The commitment to address charitable needs outside the United States carries with it a significant administrative burden. All charities have a responsibility to perform adequate due diligence to ensure that their foreign grants are used for their intended charitable purposes. In addition, when a foreign grantee does not have an IRS determination letter establishing its U.S. tax classification, sections 4945 and 4966 generally require private foundations and sponsoring organizations of donor-advised funds either to exercise expenditure responsibility over the grant or to make an "equivalency determination"—i.e., a determination that the foreign grantee meets the requirements of section 501(c)(3) and of the applicable Code provisions governing public charity or private foundation status.<sup>4</sup>

Applying U.S. tax classifications to charities from what may be an entirely different legal and cultural context remains a significant and costly challenge to U.S.-based international grantmakers. Indeed, one survey undertaken to assess the feasibility of a centralized repository

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<sup>4</sup> Under new section 4966 of the Code, donor-advised funds must exercise expenditure responsibility over any grant to an organization not described in section 170(b)(1)(A) and over grants to certain 509(a)(3) supporting organizations. Although regulations interpreting this provision have not been issued yet, the legislative history indicates that donor-advised funds will also have the option of performing equivalency determinations on foreign organizations in lieu of exercising expenditure responsibility. See Staff of the Joint Committee on Taxation, 109th Cong., *Technical Explanation of H.R. 4, the "Pension and Protection Act of 2006," as passed by the House on July 28, 2006 and as Considered by the Senate on August 3, 2006* at 349 n.526 (JCX-38-06, 2006). As discussed below in the text, the attached draft revenue procedure updates Revenue Procedure 92-94 to make it applicable to sponsoring organizations' determinations under section 4966 of the Code.

indicates that the 56 participating grantmakers collectively spend over \$2.9 million annually on equivalency determination costs alone.<sup>5</sup> And since the costs of the equivalency determination process are the same regardless of the size of the grant, they can amount to a significant percentage of a small grant. These costs will be especially onerous and in many cases prohibitive for donor-advised funds and small private foundations making smaller grants. Moreover, the financial expenses do not capture less tangible burdens such as delay (the survey indicated average times of one to four months<sup>6</sup>) and grantee alienation.

Although careful equivalency determinations will always take time and effort, right now those burdens are needlessly exacerbated because each grantmaker typically collects and evaluates grantee affidavits separately, which may result in the same information being processed multiple times for common grantees (or worse, the grantee may have to prepare slightly different versions of its information to comply with idiosyncrasies of each grantmaker's process). And while there are ways to limit the impact that language and cultural barriers have on the ED process, many grantmakers do not have a sufficient volume of equivalency determinations to justify establishing the Internet resources, field relationships, or other infrastructure to help answer local grantee questions and prevent misunderstandings. Similarly, only high-volume grantmakers are likely to have enough repeat experience in equivalency determinations to become familiar with the kinds of issues that arise over and over again in particular countries. All of these difficulties can be substantially ameliorated by centralizing the determination process.

Our proposed additions to Revenue Procedure 92-94 preserve a grantmaker's ability to make an ED based on a currently qualified grantee<sup>7</sup> affidavit. However, to encourage greater centralization of the ED process, the attached draft also allows the creation of EDIRs that gather and evaluate all necessary information and then issue equivalency certificates upon which grantmakers may choose to rely in lieu of making their own equivalency determinations. Such equivalency certificates may be issued only once the IRS has reviewed and approved the EDIR's equivalency criteria, procedures, and operations to be sure they are sufficiently rigorous.<sup>8</sup> Moreover, while a grantmaker need not double-check an EDIR's assessment of a particular grantee, a grantmaker may not rely upon an equivalency certificate if it is aware of or responsible for acts or failures to act that cause the foreign organization to fail to qualify for the tax classification stated on the certificate. Thus, there is little danger of a grantmaker using the

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<sup>5</sup> Information Age Associates, *Potential of Creating a Centralized Repository of Information on Non-U.S. Based NGOs: Findings and Recommendations*, at 24 (Dec. 2006).

<sup>6</sup> *Id.* at 32.

<sup>7</sup> We recognize that in some cases a grantmaker may decide not to make a grant to an organization for which it has completed an equivalency determination. Throughout this document, the term "grantee" should be taken to refer to such prospective grantees as well as actual grantees.

<sup>8</sup> See section 6.03 of the enclosed draft revenue procedure.

proposed EDIR alternative to treat a grantee as a particular type of charity even though the grantmaker has knowledge that would keep it from making an equivalency determination itself.

Allowing EDIRs to perform equivalency determinations on which U.S. grantmakers may rely also promises to promote tax compliance. We understand that a major focus of the Internal Revenue Service over the coming year will be ensuring that charitable funds granted overseas are used for proper charitable purposes.<sup>9</sup> Streamlining the process for relying on EDIR determinations will help in this effort by increasing the number of EDs for which the IRS has been able to review both the standards applied and the institutions applying those standards in advance. While we recognize that enforcement efforts, educational publications, and similar measures all have a role to play in assuring proper charitable use of foreign grants, Treasury should not overlook the opportunity to encourage proper equivalency determinations by facilitating the creation of appropriately rigorous EDIRs, which will hopefully be responsible for a growing percentage of all EDs made each year, and will be able to make EDs based on a depth of experience that many grantmakers could not hope to match.

There is a strong legal basis for allowing grantmakers to rely on third-party EDIRs in this way. The regulations require an organization making an equivalency determination to make a “reasonable judgment” that a recipient is described in section 501(c)(3).<sup>10</sup> This reasonable judgment standard is to be interpreted in accordance with the law of trusts.<sup>11</sup> Under that law, a trustee is allowed to be guided by information or advice from third parties in the exercise of his or her reasonable judgment. “It is ordinarily satisfactory that information or advice be obtained from sources on which the prudent . . . managers in the community customarily rely. . . . Essentially, a trustee may either possess *or hire* the degree and types of skill needed for a specific transaction or required more generally by the needs and strategies of the particular trust’s administration.”<sup>12</sup>

Indeed, modern trust law holds that while a trustee may not abdicate the whole of the trustee’s authority, a trustee has wide discretion to delegate specific decisions to third parties.<sup>13</sup> Such delegations are themselves discretionary and thus subject to the “reasonable judgment” standard. Hence, a trustee must exercise reasonable care in selecting agents, but within the bounds of a reasonable judgment, such decisions will be respected in court.<sup>14</sup> Under these

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<sup>9</sup> Robert Choi, Remarks at the Meeting of the Exempt Organizations Committee of the taxation Section of the District of Columbia Bar (Dec. 9, 2009), *in* 2009-175 EO Tax J. Email Update, EOTaxJournal@aol.com (Dec. 15, 2009).

<sup>10</sup> *See* Treas. Reg. § 53.4945-6(c)(2).

<sup>11</sup> *See id.*

<sup>12</sup> Restatement (Third) of Trusts, § 77 cmt.b, at 82-83 (emphasis added).

<sup>13</sup> *Id.* § 80.

<sup>14</sup> *Id.* cmt.d(2), at 159; *see also* Uniform Trust Code § 807(a).

standards, it seems indisputable that an organization relying on the ED of an expert third-party EDIR approved by the IRS would have satisfied the “reasonable judgment” standard. Since the “good faith” standard is a lower standard than the “reasonable judgment” standard,<sup>15</sup> the same argument also establishes that a grantmaker can rely on a third party EDIR when making a “good faith” determination of private foundation classification, as prescribed by the regulations.<sup>16</sup> Just as in the case of other areas of administration requiring special competence (such as investment decisions), grantmakers should ordinarily be considered reasonable if they rely on the conclusions of properly qualified experts, without having to make their own independent assessment of whether the experts are correct.

## **II. Revenue Procedure 92-94 Must Be Amended Promptly**

Revenue Procedure 92-94 allows grantmakers to make EDs based on “currently qualified” affidavits, and sets forth in detail the financial information that grantmakers were required to obtain from grantees claiming to pass the public support test of section 170(b)(1)(A)(vi) of the Code. The clear authorization it provides for grantmakers to treat grantees as the equivalents of public charities on the basis of a currently qualified affidavit has been crucial in enabling grantmakers to make grants to foreign organizations with confidence that they have taken adequate steps to determine the grantee’s status under U.S. tax law. However, in several key respects, intervening changes in the law have made Revenue Procedure 92-94 incorrect or unduly burdensome, complicating grantmakers’ ability to rely upon the safe harbors it provides.

First, in September 2008, the Treasury Department revised its regulations governing public charity classification, changing the method of accounting and calculation period used to determine public support, and changing the standards for determining public charity status for new organizations.<sup>17</sup> While we believe that Treasury did not intend this change to undermine grantmakers’ ability to rely on Revenue Procedure 92-94, it has rendered that revenue procedure somewhat misleading, as an organization following its literal terms would not obtain the information required to determine public charity status under current law. Moreover, because section 4.02 of the Revenue Procedure indicates that any affidavit will cease to be currently qualified if the substantive legal standards governing public charity or private operating foundation status change, some have questioned whether the September 2008 revisions terminated grantmakers’ ability to rely on affidavits based on the old standards. Given the

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<sup>15</sup> If a trust instrument removes the courts’ ability to review the reasonableness of a trustee’s decisions, a court reviews the trustee’s actions only for “good faith,” i.e. the absence conflicts of interest, recklessness, or other improper motives. Restatement (Second) of Trusts, § 187 cmt.j, at 408; Restatement (Third) of Trusts, § 87 cmt.d, at 246-47.

<sup>16</sup> See Treas. Reg. § 53.4942(a)-3(a)(6); Treas. Reg. § 53.4945-5(a)(5).

<sup>17</sup> T.D. 9423 (Sept. 8, 2008).

substantial penalties that can apply if a grantmaker fails to make a valid equivalency determination, we urge Treasury to remove any doubt as to what a grantee must do in order to rely on Revenue Procedure 92-94 by bringing its discussion of public support information into conformity with current law as soon as possible. The attached draft revenue procedure would accomplish that goal.

In addition, Revenue Procedure 92-94 is addressed solely to private foundations, even though sponsoring organizations of donor-advised funds are now also required to perform EDs with respect to foreign grantees if they do not wish to exercise expenditure responsibility.<sup>18</sup> The attached revisions clarify that sponsoring organizations, like private foundations, are entitled to use the procedures set forth in Revenue Procedure 92-94.

Finally, the revised support calculation periods of Treasury Regulation 1.170A-9T(f) and 1.509(a)-3T interact with the Revenue Procedure 92-94 to make it unduly burdensome. Under the current revenue procedure, an affidavit is currently qualified through the time period for which its financial information establishes that the organization satisfies the relevant public support test.<sup>19</sup> At the time Revenue Procedure 92-94 was promulgated, passing a public support test for a four-year period typically qualified an organization as a public charity for the two years after that four-year period.<sup>20</sup> Thus, under Revenue Procedure 92-94, an affidavit of an organization described in 170(b)(1)(A)(vi) would be “currently qualified” in 2005 if it included four years of financial information ending in either 2003 or 2004. Under the new rules, to qualify as a publicly supported charity for a given year, an organization now needs to pass a public support test on the basis of its financial support from either the five-year period ending with its current accounting year or the five-year period ending with the previous accounting year.<sup>21</sup>

These new rules, no doubt designed with after-the-fact tax filings in mind, create significant challenges for grantmakers using the equivalency process. Complete information for the current financial year can never be available until after it ends. Hence, grantmakers have access only to the five-year period ending immediately before the grantee’s current tax year as the period over which the support percentage is calculated. Moreover, since financial statements usually are not available until several months after the end of an accounting period, a grantmaker wishing to make a grant at the beginning of a new accounting period for the grantee would not have data from either the current year or the immediately preceding year. Thus, it would be unable to definitively calculate the organization’s public support percentage for any period relevant to the organization’s public charity status in the new accounting period. Furthermore, if the grantee executes an affidavit near the end of the grantee’s accounting period, it may only be a matter of weeks or months before that affidavit expires and must be updated again.

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<sup>18</sup> See note 4, *supra*.

<sup>19</sup> Rev. Proc. 92-94, § 4.05.

<sup>20</sup> Treas. Reg. § 1.170A-9(e)(4)(i).

<sup>21</sup> Treas. Reg. § 1.170A-9T(f)(4)(i); Treas. Reg. § 1.509(a)-3T(d)(1).

The proposed revisions address this issue by allowing a grantmaker to rely on an affidavit that establishes 501(c)(3) and public charity status for the most recently completed fiscal year. Thus, assuming all other requirements were met, an organization's affidavit could be "currently qualified" in 2011 if it contained financial data establishing that the organization satisfied the public support test for 2010, i.e., based on a support period from 2005 to 2009 or from 2006 to 2010.

In light of the foregoing legal changes and their impact on Revenue Procedure 92-94, we urge Treasury to act quickly to update Revenue Procedure 92-94 so that all grantmakers subject to the equivalency determination/expenditure responsibility regime will have clear authorization to use the simplified procedures set out in that revenue procedure, and clear guidance as to how to implement those procedures under current law.

### **III. Other Specific Proposed Changes to Revenue Procedure 92-94**

We have tried to keep our proposed revenue procedure as close to Revenue Procedure 92-94 as possible, and most of the changes speak for themselves. However, besides adding provisions governing EDIRs and conforming to present law, we have made a few other proposed changes worth summarizing here:

1. **Public Support Calculations.** Currently, international organizations such as the United Nations and all foreign governments, foreign government instrumentalities, foreign public universities, and foreign charities meeting the section 170(b)(1)(A)(vi) public support test are treated as section 509(a)(1) public charities for purposes of section 4945.<sup>22</sup> However, there has been some doubt about whether a grantmaker evaluating the public support of a foreign organization receiving funding from such sources may treat such funding as 100% public support under the section 170(b)(1)(A)(vi) support test, as it could in the case of funding from a domestic government entity or 170(b)(1)(A)(vi) public charity.<sup>23</sup> Because the section 170(b)(1)(A)(vi) test originally applied only to domestic entities eligible to receive tax-deductible contributions under section 170, the provision allowing such treatment is worded in terms of domestic government entities and public charities. Since the regulations exhibit a clear intent to apply the section 170(b)(1)(A)(vi) test to foreign organizations without regard to their place of incorporation, foreign organizations should not fare worse under the section 170(b)(1)(A)(vi) public support test simply because their support comes from foreign rather than domestic public sources.<sup>24</sup> The proposed revisions make clear that such sources are included 100% in public support for

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<sup>22</sup> Treas. Reg. § 53.4945-5(a)(4).

<sup>23</sup> Treas. Reg. § 1.170A-9T(f)(6)(i).

<sup>24</sup> 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 includible in public support without limitation).

purposes of determining the public charity status of foreign grantees. This clarification is in accordance with another recommendation of the Advisory Committee on Tax Exempt and Government Entities.<sup>25</sup>

2. **Lobbying and Political Activities.** Revenue Procedure 92-94 indicates that grantees should attest that they are forbidden from engaging in political campaign intervention and substantial lobbying activities.<sup>26</sup> In many countries, there is no such prohibition. However, organizations that do not engage in such activities and do not have governing documents that expressly empower them to do so comply with the requirements of section 501(c)(3).<sup>27</sup> We have revised the revenue procedure's model affidavit to make this clear.
3. **Racial Nondiscrimination.** The attached draft continues the practice of requiring educational institutions to attest that they operate according to a policy of nondiscrimination. However, it does not require compliance with the specific procedures for publicizing that policy set forth in Revenue Procedure 75-50. In our view, it is unreasonable to expect foreign organizations that may have very different histories with respect to racial discrimination to know about and comply with these U.S.-specific requirements.
4. **Material Changes in Support.** Prior law applied a special calculation period for determining public support if there had been a "material change" in an organization's sources of support.<sup>28</sup> As that standard has been removed, we have removed corresponding references to when grantmakers would be considered responsible for or aware of such a change.
5. **New Organizations.** Under current law, new organizations' public charity status under section 170(b)(1)(A)(vi) or 509(a)(2) for the first five years is determined based on whether there is a "reasonable expectation" that they will meet the applicable public support test by the end of that five-year period.<sup>29</sup> The proposed revenue procedure indicates that equivalency determinations may apply the same test, based on the same information the IRS requests on a Form 1023.
6. **Electronic Affidavits.** The proposed revenue procedure clarifies that a physically signed affidavit is not essential. This is to enable the electronic collection of equivalency information.

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<sup>25</sup> Advisory Committee Report, *supra* note 2, at 14-20. The Advisory Report recommends a slightly different version of this proposal, for instance excluding support provided by OFAC-sanctioned countries. We have followed the current regulations, on the theory that any organization that can be treated as a public charity for purposes of receiving grants should also be treated as a public charity for purposes of providing grants to others. However, we are happy to discuss the details of this proposal with you.

<sup>26</sup> Rev. Proc. 92-94 § 5.04(8)-(9), 1992-1 C.B. 507.

<sup>27</sup> See I.R.C. § 501(c)(3); Treas. Reg. § 1.501(c)(3)-1(b)(3), -1(c)(3).

<sup>28</sup> Treas. Reg. § 1.170A-9(e)(4)(v).

<sup>29</sup> Treas. Reg. § 1.170A-9T(f)(4)(v); Treas. Reg. § 1.509(a)-3T(d)(1).

7. **Increased Flexibility.** While most equivalency determinations will simply apply the standard laid out in Revenue Procedure 92-94 (as revised), the new revenue procedure also allows the IRS to approve other procedures of an EDIR on a case-by-case basis. Thus, for instance, an EDIR encountering a large number of grants to foreign medical research organizations could design a special form of affidavit or questionnaire that it could use, upon obtaining IRS approval of the standards employed, to determine a grantee's qualification as a medical research organization.
8. **Materials not provided by the grantee.** Revenue Procedure 92-94 assumes that materials will be provided by the grantee. However, translations and public information about laws may be more readily available from other sources. The attached draft revisions clarify the standards for such materials and grantmakers' ability to rely on them. Also, the draft continues to allow grantmakers to rely on grantee affidavits that they do not receive directly from the grantee.

#### IV. Conclusion

We are convinced that adopting the proposed changes to Revenue Procedure 92-94 would substantially ease the burdens of the equivalency determination process while simultaneously helping to advance the government's interest in assuring high standards are applied throughout the equivalency determination process. Indeed, while we recognize the large number of exempt organizations guidance projects currently in process, we are hopeful that revisions to Revenue Procedure 92-94 could be accomplished with relatively little effort, so that grantmakers will have a procedure upon which they can more clearly rely. We would welcome the chance to speak to you about this proposal and any questions you may have as soon as possible. Please do not hesitate to give me a call at [insert number] at your convenience.

Sincerely,



Steve Gunderson

Enclosures

cc: Emily Lam, Attorney Advisor, Office of Tax Policy  
Sarah Hall Ingram, Commissioner, TE/GE  
Lois Lerner, Director, Exempt Organizations Division, TE/GE  
Cathy Livingston, Deputy Division Counsel/Deputy Associate Chief Counsel (Exempt Organizations/Employment Tax/Government Entities), TE/GE