DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

APR 1 8 2001

John A. Edie, Esq
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1828 L Street, NW
Washington, DC 20036

Dear Mr. Edie:

This letter responds to your request for general information on the treatment of grants made by private foundations to foreign grantees which have not applied for recognition of tax-exempt status. To answer the particular question that you asked, neither the Internal Revenue Code nor the Regulations require a private foundation to determine whether a foreign grantee is described in section 501(c)(3) of the Internal Revenue Code. Therefore, a U.S. private foundation may elect to treat a foreign grantee as not being described in section 501 (c)(3). If the U.S. private foundation makes a grant to the foreign charity for one or more purposes described in section 170(c)(2)(B) and exercises expenditure responsibility with respect to the grant in accordance with the requirements of section 4945(h) and the regulations thereunder, then the grant will be a qualifying distribution under section 4942 and not a taxable expenditure under section 4945. A more detailed explanation of the relevant statutory provisions and regulations follows.

Section 4942 of the Code requires a private foundation (other than an operating foundation described in section 4942(j)(3)) to pay an excise tax to the extent its qualifying distributions in a taxable year fall below its distributable amount, as defined in section 4942(d), for the taxable year.

Section 4942(g)(1) of the Code generally defines a “qualifying distribution” as any amount paid to accomplish purposes described in section 170(c)(2)(B), including charitable purposes, except for a distribution made to an organization controlled by the foundation or a distribution made to another private foundation which is not an operating foundation.

Section 4942(g)(3) of the Code provides that a contribution from a private foundation to another private foundation which is not an operating foundation will be treated as a qualifying distribution if the recipient foundation makes a qualifying distribution of the same amount which is treated as a distribution “out

of corpus" by the end of the first taxable year following the taxable year in which the contribution is received and the recipient foundation maintains adequate records. In general, a distribution will be treated as a distribution "out of corpus" only if the recipient foundation had made other qualifying distributions at least equal to its distributable amount. See Section 53.4942(a)-3(d) of the Foundations and similar excise taxes regulations.

Section 4945(a) of the Code requires a private foundation to pay an excise tax on any taxable expenditure that it makes.

Section 4945(d)(4) of the Code provides that a grant to an organization other than a section 501 (c)(3) organization described in section 509(a)(l) (2) or (3) will be a taxable expenditure unless the private foundation making the grant exercises expenditure responsibility with respect to the grant.

Section 4945(h) of the Code provides that to exercise expenditure responsibility, a private foundation must see that its grant is spent solely for the charitable or other exempt purposes for which it was made; obtain full and complete reports from the grantee confirming how the grant was spent; and provide full and detailed reports on such expenditures to the IRS.

Section 508(a) of the Code generally prohibits an organization from being treated as described in section 501(c)(3) unless it has filed notice with the Secretary of the Treasury that it is applying for recognition of such status. The Secretary prescribes the method for filing the notice. Section 508(c) provides an exception for churches and their integrated auxiliaries, and organizations that normally have annual gross receipts of $5000 or less, permitting them to be treated as described in section 501(c)(3) even if they have not submitted an application to the IRS and received a determination letter.

Section 4948(b) of the Code provides that the requirements of section 508 do not apply to foreign organizations receiving substantially all of their support (other than gross investment income) from sources outside the United States.

Section 53.4942(a)-3(a)(6) of the regulations provides that distributions, for section 170(c)(2)(B) purposes, to a foreign organization that has not received a determination letter confirming that it is an organization described in section 509(a)(1), (2), or (3) or section 4942(j)(3) of the Code will be treated as a distribution made to an organization described in section 509(a)(l), (2) or (3) or 4942(j)(3) if the distributing foundation has made a good faith determination (as defined in the regulation) that the donee organization is an organization described in section 509(a)(1), (2) or (3) or section 4942(j)(3).

Section 53.4945-5(a)(5) of the regulations provides that if a private foundation makes a grant to a foreign organization that has not received a determination letter confirming that it is an organization described in section

509(a)(1), (2), or (3) of the Code, such a grant will be treated as a distribution made to an organization described in section 509(a)(l), (2) or (3) if the distributing foundation has made a good faith determination (as defined in the regulation) that the grantee organization is an organization described in section 509(a)(1), (2) or (3).

Section 53.4945-5(b)(5) of the regulations specifically contemplates expenditure responsibility grants made to a foreign organization that is not described in section 509(a)(1), (2) or (3) of the Code and provides that in meeting expenditure responsibility for such a grant, the written grant agreement will be deemed to satisfy the requirements of Sections 53.4945-5(b)(3)(iv) and 53.4945-5(b)(4)(iv) of the Regulations if it subjects the grantee to restrictions substantially equivalent to those imposed on domestic private foundations under section 4945(d).

Section 53.4945-6(c) of the regulations provides that a private foundation cannot make a grant to an organization not described in section 501(c)(3) of the Code unless the grantee holds the grant in a separate fund dedicated to one or more purposes described in section 170(c)(2)(B). The regulation further provides that a foreign organization that does not have a determination letter concluding that it it is described in section 501 (c)(3) will be treated as described in section 501 (c)(3) if a foundation manager makes a reasonable judgment (as defined in the regulation) that the grantee is described in section 501 (c)(3).

Section 1.508-1 (a)(2) of the regulations provides that to satisfy the notice requirement of section 508(a) of the Code, an organization must submit a properly completed and executed Form 1023, Exemption Application, to the district director.

Section 53.4948-1(b) of the regulations provides that section 508 of the Code does not apply to any foreign organization which, since the date of its creation, has received at least 85% of its support from sources outside the United States. Support for these purposes is as defined in section 509(d), other than section 509(d)(4), and, therefore, does not include gross investment income.

Revenue Procedure 92-94, 1992-2 C.B. 507 informs private foundations that for purposes of the regulations under sections 4942 and 4945 of the Code, a private foundation will be treated as having made a reasonable judgment that a foreign organization is described in section 501 (c)(3) and a good faith determination that a foreign organization is described in section 509(a)(1), (2), or (3) or section 4942(j)(3) if it collects certain specified information from the foreign grantee in the form of a sworn affidavit that is current through the close of the grantee's latest complete accounting year. Section 4.06 specifically provides that private foundations are permitted but not required to use the procedures described in making grants to foreign organizations.

As you correctly outlined in your request for information, the combination of these provisions from the Internal Revenue Code and the Treasury Regulations lead to the conclusion that a grant from a private foundation to a foreign grantee will be treated as a qualifying distribution for purposes of section 4942 of the Code and not as a taxable expenditure for purposes of section 4945 under each of the following three circumstances:

(1) After making a good faith determination that the foreign grantee is described in sections 501(c)(3) and 509(a) of the Code, Le. the foreign grantee is the equivalent of a "public charity," the private foundation makes the grant without exercising expenditure responsibility.
(2) After making a good faith determination that the foreign grantee is described in section 501 (c)(3) of the Code and would be classified as a private foundation because it is not described in section 509(a), the private foundation exercises expenditure responsibility with respect to the grant as prescribed by section 4945(h) and the regulations thereunder, and obtains records verifying that the grantee distributes the full amount of the grant out of corpus by the end of the year following the year in which the grant is made, in accordance with section 4942(g)(3).
(3) The private foundation treats the grantee as not being described in section 501 (c)(3) of the Code and exercises expenditure responsibility with respect to the grant as prescribed by section 4945(h) and the regulations thereunder, including the requirement that the grantee maintain the grant funds in a separate fund dedicated for section 170(c)(2)(B) purposes, in accordance with Section 53-4945-6(c) of the Regulations.

Nothing in the statute or regulations requires a private foundation to inquire or evaluate whether it can make a good faith determination that a foreign grantee is described in section 501 (c)(3) or 509(a) of the Code. Furthermore, the clear import of the regulations is to treat a foreign grantee as described in section 501 (c)(3) and, where applicable, section 509(a), only if the foreign grantee has received a determination letter from the IRS confirming that status, or the grantor private foundation has made a good faith determination of that status in accordance with appropriate procedural requirements. That the grantor private foundation may have the capacity to make a good faith determination with respect to a particular foreign grantee or may have embarked on the procedure to collect the necessary information to make a good faith determination but not reached a definitive conclusion is not relevant. That another private foundation has made a good faith determination with respect to a particular foreign grantee is also not relevant. Therefore, if a private foundation makes a grant for exclusively charitable purposes to a foreign grantee and exercises expenditure responsibility without first attempting to make a good faith determination that the foreign grantee is described in section 501 (c)(3) or after abandoning an inconclusive effort to make such a determination, the grant will be a qualifying

distribution for purposes of section 4942 and will not be a taxable expenditure for purposes of section 4945.

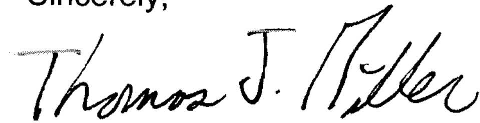
You also requested information about the potential application of section 4948(b) of the Code when a U.S. private foundation makes a grant to a foreign organization. You asked for confirmation that the Internal Revenue Service ("IRS") would not use the authority provided by section 4948(b) to require a U.S. grantmaking foundation to treat a foreign grantee as a private foundation. Section 4948(b) permits, but does not require, the IRS and other taxpayers to treat a foreign organization that receives substantially all of its support (other than gross investment income) from outside the United States as a section 501 (c)(3) organization even if the organization has not applied for and received a determination letter. (Section 508 dictates the opposite result for most domestic organizations. The IRS and other taxpayers are permitted to treat a domestic organization as described in section 501 (c)(3) only if the organization has submitted an application to the IRS claiming section 501 (c)(3) status.)

As discussed above, a private foundation retains full discretion and may elect to treat a foreign grantee, which has not received a determination letter from the IRS, as not being described in section 501(c)(3) of the Code even if it may be possible for the private foundation to make a good faith determination to the contrary. The IRS may have the authority to characterize the same foreign grantee differently, but nothing in the statute or regulations compels it to do so. Therefore, the IRS will respect how a grantmaking foundation treats a foreign grantee for purposes of applying sections 4942 and 4945. if the grantmaking foundation has treated a foreign grantee as a noncharitable entity, a grant to that foreign grantee for exclusively charitable purposes will be treated as a qualifying distribution and not as a taxable expenditure if the appropriate expenditure responsibility requirements have been met. The IRS will not recharacterize the foreign grantee as described in section 501 (c)(3) so that the out of corpus rules of section 4942(g)(3) could potentially apply as long as the grantee has not applied for and received an IRS determination letter.

Finally, we note that certain U.S. income tax treaties contain specific provisions relating to income received by and contributions made to charitable organizations. Nothing in this letter is intended to affect the interpretation or application of those treaty provisions.

If you have any questions about the contents of this letter, please contact Karim H. Hanafy (Identification Number 50-18878) at (202) 283-8887 (not a toll-free call).

Sincerely,



Thomas J. Miller
Acting Director
Rulings and Agreements