



LEGAL DIMENSIONS OF INTERNATIONAL GRANTMAKING

IRS Affirms Streamlined Approach to International Grantmaking by Foundations

By Council on Foundations Legal Staff

Council on Foundations Secures Information Letter Affirming that Expenditure Responsibility May Be Used for Most Cross-Border Foundation Grants

The Council on Foundations has secured a general information letter from the Internal Revenue Service (IRS) affirming that private foundations may use expenditure responsibility procedures for most of their international grants. The April 18, 2001, letter confirms that foundations need not attempt to determine whether a potential grantee is the equivalent of a U.S. charitable organization before turning to expenditure responsibility. This letter is the result of a two-year effort by the Council and its members to secure guidance that will streamline and encourage international grantmaking.

Background. To ensure that their international grants are in compliance with the tax code requirements, private foundations have for many years seen the applicable Treasury regulations as offering two approaches to such grantmaking: *equivalency determination* and *expenditure responsibility*. For equivalency determinations, foundations must gather information and documents to demonstrate that the potential grantee is the equivalent of a U.S. public charity. Depending on the situation, this process may involve examining years of financial records, translating organizational documents into English and even reviewing applicable foreign laws in translation. Despite the introduction of a sample equivalency affidavit in 1992, for many foundations equivalency determination continues to be complex, time-consuming and costly. In some cases, foreign law and differences in accounting practices can raise technical barriers to making an equivalency determination with respect to a particular foreign organization.

Many Foundations Prefer Expenditure Responsibility. Given the challenges of making equivalency determinations, many foundations have found

that exercising expenditure responsibility is a preferable method for making grants to organizations outside the United States. This process involves a pre-grant inquiry into the capacity of the grantee to administer a charitable grant, execution of a grant agreement, maintenance of the funds in a special account and follow-up reporting and disclosure on the grantmaker's annual information return, Form 990-PF. For many foundations, the prescribed expenditure responsibility process is not significantly different or more onerous than their general grantmaking procedures.

Written Clarification Sought to Remove Lingering Concerns. What has kept many foundations from using expenditure responsibility exclusively, however, has been a concern that the Treasury regulations may require foundations to undertake an initial review to determine whether the potential grantee fails to qualify as the equivalent of a U.S. charity equivalent *before* exercising expenditure responsibility. A close reading of the Tax Code supports the conclusion that a foreign organization could automatically be treated as not the equivalent of a U.S. charity, and that expenditure responsibility could be exercised without considering equivalency. However, there was nothing in writing that confirmed this position. In the absence of such guidance, many legal advisors (including the Council on Foundations) have long counseled foundations that they should attempt to make a good faith determination of whether the potential grantee is the equivalent of a U.S. charity before turning to expenditure responsibility.

Go Straight to Expenditure Responsibility. Encouraged and guided by a group of Council members known as U.S. International Grantmakers (USIG), the Council—with assistance from its outside counsel at Caplin & Drysdale—requested clarification from the IRS and the Department of Treasury. In response, the IRS has now confirmed that nothing in the Tax Code or Treasury regulations requires a foundation to inquire or evaluate whether an equivalency determination can be made before undertaking expenditure responsibility. In other words, a private founda-



tion may treat a foreign organization as a *non-charity* from the outset. The letter also makes clear: (1) that a private foundation may turn to expenditure responsibility at *any point*, such as when its efforts to make such a determination about the charitable status of the entity have been unsuccessful or inconclusive; (2) that a private foundation is not affected by another foundation's decision to use an equivalency determination with respect to the same grantee; and (3) that the IRS will not generally recharacterize a foreign grantee as a private foundation if the grantor foundation has characterized the grantee as a non-charity and performed all the requirements of expenditure responsibility.

Other Approaches to Cross-Border Grantmaking by Foundations Are Unaffected.

A private foundation's ability to use equivalency determination is not affected by this information letter. Some foundations may still find that an equivalency determination is an easier approach, given the kind of foreign grantmaking they do or the way they have organized their foreign grants administration. In some situations—notably grants for endowments, capital equipment and general operational support—technical difficulties in satisfying the requirements for expenditure responsibility are likely to make an equivalency determination a *preferable* approach, where such a determination is possible for the grantee in question. In addition, this letter does not in any way alter the procedures and options made available in

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some U.S. tax treaties with other countries, such as Mexico and Canada.

While general information letters are advisory in nature and have no binding effect on the IRS, they are intended to provide clarification of well-established interpretations of law. We believe that all U.S. private foundation grantmakers may be confident that the information letter obtained by the Council faithfully describes the IRS's views on expenditure responsibility.

Conclusion. The Council is pleased that the IRS has affirmed this streamlined approach to international private foundation grantmaking. We are hopeful that the information letter on expenditure responsibility will encourage foundations with international interests to begin or expand their giving abroad. We are also pleased to note that the Council has just released a new work, *Expenditure Responsibility Step by Step*, by John Edie, which provides a detailed introduction to all aspects of exercising expenditure responsibility and contains a wealth of sample forms. Copies may be ordered online through www.cof.org or by calling 1-888-239-5221. An

Adobe PDF version of the IRS's general information letter on expenditure responsibility for international grantmaking may be downloaded from the Council's Web site at: <http://www.cof.org/government/index.htm>. For further information, call John Edie or Jane Nober in the Council's Legal Services department, 202/467-0466.