Charitable Contributions and Grants Beyond the U.S. Border

By Cory Halliburton

Once upon a time, a U.S. charity received written curriculum materials from a school organization located in a very poor and far away island country. The kind and cute children identified in photographs submitted were clearly engaged in learning; a charitable class and purpose were identified. The colorful stamps affixed on the school's governing documents appeared authentic, and the school's leaders' correspondence and pleas for financial help were thoughtful and well written.

Indeed, the U.S. charity was extremely excited and anxious to execute this long-awaited program to advance education and charity on a global scale. The intended grant was substantial, and thus the U.S. charity ultimately, albeit reluctantly, decided to engage a consultant to travel to and perform a site-inspection of the school. Upon return, the consultant provided photographs of the "school" – an abandoned shack with no desks, no windows, no chairs, no blackboard, no students, no curriculum and no teachers. Nothing. The solicitation was a sham.

The U.S. charity was perilously close to contributing hundreds of thousands of dollars for the exclusive benefit of a foreign scam artist. The due diligence put forth by the U.S. charity was commendable and avoided potential violation of a multitude of tax regulations. Moreover, the U.S. charity and all involved learned many valuable lessons through the process.

Now more than ever, individuals, private foundations and public charities have a strong desire to advance charitable missions globally. However, there are specific and sometimes complex tax regulations and real-life challenges that should give pause to those eager to cross borders with intended charitable contributions or assets dedicated exclusively for charitable purposes.

This article provides information about how individuals and domestic charities (public charities and private foundations) may engage in and enjoy tax benefits (or protections) associated with giving beyond the U.S. border.

Charitable Contribution

First, it is helpful to review the definition of a "charitable contribution" because the concept ebbs and flows throughout many situations of giving beyond the U.S. border.

For purposes of allowance of a charitable deduction under section 170 of the Internal Revenue Code, "charitable contribution" means contribution or gift to or for the use of – a corporation, trust or community chest, fund or foundation:

(A) organized in the United States or in any possession thereof, or under the law of the United States, any state, the District of Columbia or any possession of the United States;
(B) organized and operated exclusively for charitable purposes;
(C) no part of the net earnings of which inures to the benefit of any private individual; and
(D) which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation or participating in elections for public office.[1]

Individual Donations

As defined, a "charitable contribution" does not include a gift made to a corporation, trust etc. organized in or under the laws of a foreign government or country not specified in section 170(c)(2)(A) of the code. Thus, and except in limited situations, individuals are not permitted to claim a charitable contribution deduction for donations made to foreign organizations, even if the organization is recognized as charitable under applicable foreign law.

There are, however, a few ways in which individuals may satisfy their urge to impact the world beyond the U.S. border and still obtain charitable contribution tax benefits.

For example, individuals may donate to a qualified U.S. charity that engages in charitable works beyond the U.S. border or that, as part of its overall charitable program, makes and has the human capital and financial wherewithal to administer charitable grants to foreign organizations. Also, an individual may donate to a foreign subsidiary of a U.S. charity – sometimes referred to as "friends of" organizations – provided that the U.S. charity in fact controls and oversees the foreign entity's administrative and other activities.

These opportunities are indirect means for an individual to touch the world on a global scale and still reap charitable contribution tax benefits. Moreover, the risk associated with the foreign contribution is likely reduced, and the likelihood that the contribution will benefit a charitable class or purpose is likely increased.

However, if a contribution has been earmarked for a foreign recipient, then the analysis goes beyond the immediate domestic recipient to determine whether the payment constitutes a deductible contribution.[2] For example, the domestic recipient cannot exist solely to funnel contributions to a foreign organization. Under section 170 of the code, no charitable contribution exists where the domestic organization serves solely as a nominal donee. Indeed, "[a] given result at the end of a straight path is not made a different result because reached by following a devious path."[4]

Rather, the domestic charity must engage in sufficient charitable operations within the United States in order to qualify as a domestic charity to which charitable contributions may be made. Also, the contribution cannot be earmarked for submission to a specific foreign organization, and void of discretion and oversight of the receiving U.S. charity. The domestic U.S. charity must have and maintain control and oversight responsibility over the funds intended for or granted to the foreign organization.[5]

Essentially, the individual's contribution must be a gift to a qualified domestic charity; that is, a transfer of an asset with donative intent, disinterested generosity and with no return goods or services. If the domestic recipient exists for no other legitimate reason except to serve as a conduit for a foreign recipient, such services will essentially destroy the donative intent necessary to qualify a charitable contribution under section 170 of the code. The U.S. charity should have discretion and control over whether and how much of the individual's contribution may be delivered across the U.S. border, to whom it may be delivered, and how it may and must be monitored for advancement of qualified charitable purposes.

Private Foundations[6]

For private foundations, foreign grant-making entails the concept of taxable expenditures. Section 4945 of the code imposes an excise tax on a private foundation's "taxable expenditures," and the applicable tax may be assessed against the foundation, with an additional tax assessed against the foundation's managers who knowingly permit a taxable expenditure.[7] Thus, most private foundations (and their managers) usually try dearly to avoid taxable expenditures.

Briefly, a taxable expenditure includes "any amount paid or incurred" by a private foundation (1) for any purpose that is not a valid charitable purpose described in section 170(c)(2)(B) of the code (noted above), or (2) as a grant to an organization, unless (i) the grant is made to certain types of U.S. charities (or to a foreign equivalent of a U.S. public charity); or (ii) the foundation exercises expenditure responsibility according to subsection 4945(h) of the code.[8]

Thus, private foundations that desire to engage in grants beyond the U.S. border must engage in pre-grant efforts to qualify the foreign grant recipient, must exercise expenditure responsibility, or may execute a blend of both previous options without violating the requirements of either.

What is a 'Grant?'

First, the private foundation should determine whether the amount paid or incurred is a "grant." In this context, "grants" include amounts spent by a recipient organization to carry out a charitable activity; scholarships, fellowships, internships, prizes and awards; loans for charitable purposes described in section 170(c)(2)(B) of the code (noted above); and program-related investments.[9] Conversely, grants do not include compensation to the foundation's employees or payments to others for personal services in assisting the foundation in developing projects of foreign program activities.[10]

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If the foundation determines that the amount to be paid to a foreign organization will constitute a grant, the foundation must decide whether it will exercise expenditure responsibility over the grant or will properly qualify the foreign organization as the equivalent of a public U.S. charity.

Expenditure Responsibility

The requirements of expenditure responsibility are too detailed to adequately describe in this article. However, the requirements may be summarized as follows:

(1) the granting foundation must screen the intended grantee before assets are contributed;
(2) the granting foundation and the recipient foreign organization must execute a grant agreement that describes, among other things, the charitable activity to be accomplished;
(3) the granting foundation must require and receive progress reports regarding the activities advanced by the grant; and
(4) the foreign grantee must provide (and make available upon request) financial books and records evidencing how the funds were spent.[11]

Pre-grant screening should include identity, past experience, management, activities and practices of the foreign organization.[12] The scope of the inquiry may vary from case to case depending upon the size and purpose of the grant, the period over which the grant is to be paid and the prior experience that the grantor had with respect to the capacity of the grantee to use the grant for the proper purposes.[13]

To meet the expenditure responsibility requirements, the grant must be made under a written grant agreement that prescribes the charitable purposes for the grant. The foreign organization must agree to repay any amount that is not used for the purposes of the grant, and to affirm that the grant will not be used to influence legislation, the outcome of any specific public election or any voter registration drive. The foreign organization must also agree to maintain records of receipts and expenditures, and to make its books and records available to the grantor foundation.[14]

Any diversion of grant funds for a use not specified in the grant agreement may result in that part of the grant being treated as a taxable expenditure to the grantor foundation. If a grantor foundation determines that any part of the grant has been used for improper purposes (and the grantee has not previously diverted grant funds) the foundation will not be treated as having made a taxable expenditure if the grantor: (1) exerts reasonable efforts to recover amounts not used according to the agreement; and (2) withholds further payments to the grantee, after being made aware that a diversion of funds may have occurred, until assurances are given that future diversions will not occur due to additional and extraordinary precautions engaged by the foreign recipient.[15]

Reports on the Expenditures to the IRS

To satisfy the report-making requirements involved in expenditure responsibility, a grantor foundation must provide the required information on its IRS Form 990-PF annual tax return as long as grantee reporting on that grant is required.[16] The reports must include:

(i) The name and address of the grantee.
(ii) The date and amount of the grant.
(iii) The purpose of the grant.
(iv) The amounts expended (based upon the grantee's most recent report).
(v) Whether the grantee has diverted any portion of the funds.
(vi) The dates of any reports received from the grantee.
(vii) The date and results of any verification of the grantee's reports undertaken by the grantor.[17]

If the grantor foundation fails to comply with the expenditure responsibility requirements, such as by failing to conduct a proper pre-grant inquiry, failing to use a proper grant agreement or failing to report properly to the IRS, the grant will likely constitute a taxable expenditure.

Foreign Equivalency Determination

If the private foundation does not desire to exercise expenditure responsibility, the foundation may seek to qualify the foreign organization as the equivalent of a public U.S. charity, unless the foreign grantee has a determination letter from the IRS. To so qualify a foreign grantee, the private foundation must make or receive a good faith determination that the grantee is the equivalent of an organization described in section 509(a)(1), (2) or (3) of the code, which, generally speaking, includes public charities, churches, educational organizations or any arm of the U.S. or any state political subdivision.

Revenue Procedure 92-94, 1992-1 C.B. 507, as amended by Treasury Decision 9740 (effective Sept. 25, 2015) provides procedures that a domestic foundation must use to determine whether a grant to a foreign organization may be treated as a grant to an organization described in section 509(a)(1), (2) or (3) of the code. The procedures allow a grantor to distinguish a qualifying distribution from a taxable expenditure under section 4945 of the code and they allow a useful path for private foundations to engage in international grant making.

Briefly, the foreign grantee organization will usually provide an affidavit (translated in English) that includes representations about how and why the organization qualifies as the equivalent of a U.S. public charity. The affidavit should be current (as described in T.D. 9740) and include verified copies of governing documents (translated) as well as a schedule of financial information to verify sufficient receipts from the donating public so as to qualify the organization as a public charity. Then, the grantor foundation, through a "qualified tax practitioner," makes a good faith determination on whether the foreign organization is qualified based on the information provided.[18]

Revenue Procedure 92-94 includes the requirements for the affidavit and provides sample language. However, Treasury Decision 9740 makes clear that grantor foundations should not rely solely on the sample affidavit completed by the foreign grantee. Rather, the grantor foundation should dive deeper into governance documents, program materials and other organizational and operational matters relevant to qualifying the foreign organization as the equivalent of a U.S. public charity. Essentially, a grantor foundation (or its qualified tax practitioner) is wise to scrutinize a foreign organization's request

for funding in a manner similar to the scrutiny expected of the IRS in regard to its review of a domestic organization's Form 1023 Application for Recognition of Exemption Under Section 501(c)(3) of the code.

Grants to Foreign Governments

No equivalency determination or expenditure responsibility is required for grants to a foreign governmental unit.[19] Nonetheless, the granting foundation should document that the grantee is a unit of foreign government. Also, the grant arrangement must identify and advance a charitable purpose, as opposed to a purely governmental or political purpose. General support grants to foreign governments are not prohibited, but the granting foundation may have a difficult time accounting for the charitable purpose achieved by the grant. If a specific, charitable purpose is identified, the granting foundation may more easily monitor and account for the appropriateness of the grant.

Suspected Terrorists

At the risk of being obtuse, no funds should be granted to individuals or organizations designated as suspected terrorists by the U.S. Department of the Treasury or the U.S. Federal Government's Office of Foreign Assets Control (OFAC). OFAC publishes a list of individuals and companies owned or controlled by, or acting for, targeted countries, and OFAC also lists individuals, groups and entities, such as terrorists and narcotics traffickers designated under programs that are not country-specific, whose assets are generally blocked.

Links to these lists may be included in grant agreements, and foreign grantees may affirm that neither the grantee nor any of its officers, control persons, etc. are designated as suspected terrorists on the applicable lists.

Public Charities

The expenditure responsibility rules and foreign equivalency rules do not apply to domestic public charities. However, public charities must ensure that their assets are used exclusively to achieve or advance a charitable purpose. Thus, public charities should refrain from general support grants to foreign organizations unless the foreign organization has been qualified as the equivalent of a U.S. public charity. Without qualifying the foreign grantee, the domestic grantor will have great difficulty identifying the charitable purpose achieved with a general support grant, which could jeopardize the domestic charity's tax exemption.

A better approach is for the domestic public charity to engage in project-specific grants to foreign organizations. This allows the grantor charity the ability to identify a specific, charitable objective to be achieved with the grantor's assets. The grantor will be in a much better position to document and receive reports regarding the specific charitable objective achieved through the grant.

In any event, and especially if the grant is substantial, the domestic public charity should consider entering into a grant agreement with the foreign grantee. The agreement may identify the purpose of the grant, reporting requirements, protocol for disbursement of funds, repercussions for violating the agreement and affirmation that the foreign grantee is not a terrorist organization.

Closing Considerations

The foregoing constitutes some high-level concepts and tax issues to consider when charitable contributions or charitable assets are expected to cross the U.S. border. Domestic organizations may find that initial foreign grant programs are cumbersome and even administratively costly. However, through the development of a focused and compliant foreign grant program, the domestic organization will likely settle well into a manageable budget as well as the applicable tax regulations. By doing so, domestic organizations should be in a position to honor the privilege of tax-exemption and truly affect change on a global scale.

Footnotes

1. *See* 26 U.S.C. § 170(c)(2)-(2)(D).
2. *See* Rev. Rul. 63-252, 1963-2 C.B. 101; Rev. Rul. 54-580, 1954-2 C.B. 97.
3. *See* Rev. Rul. 63-252, 1963-2 C.B. 101.
4. *Id.* quoting *Minnesota Tea Co. v. Helvering*, 302 U.S. 609, 613 (1938)).
5. *See* Rev. Rul. 75-65, 1975-1 C.B. 79.
6. *See* 26 U.S.C. § 170(b)(1)(A)(v), (c)(1) (setting forth defining characteristics of a private foundation).
7. *See* id. at § 4945(a)(1)-(2).
8. *See* id. at § 4945(d)(4), (d)(4)(B), (h)-(h)(3).
9. *See* 26 C.F.R. § 53.4945-4(a)(2).
10. *See id.*
11. *See id.* at § 53.4945-5(b)-(b)(iii).
12. *See id.* at § 53.4945-5(b)(2).
13. *See id.*
14. *See id.* at § 53.4945-5(b)-(b)(3).
15. *See id.* at § 53.4945-5(e)(1).
16. *See id.* at § 53.4945-5(d)(1).
17. *Id.* § 53.4945-5(d)(2)-(2)(vii).
18. A "qualified tax practitioner" includes certified public accountants, enrolled agents, as well as attorneys who are subject to the standards of practice before the IRS set out in Circular 230. *See* T.D. Cir. No. 230 §§ 10.2(a)(1), 10.2(a)(3).
19. *See and compare* 26 U.S.C. § 4945(d)(4) *and* 26 C.F.R. § 53.4945-5(a)(4)(iii) (noting that a grantee organization will be treated as a section 509(a)(1) organization if it is a foreign government, or an instrumentality thereof), *with* 26 U.S.C. § 170(b)(1)(A)(v), (c)(1) *and id.* at § 509(a)-(a)(4) (omitting foreign governments from the list of organizations to which a charitable contribution may be made).

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