

International Grant-making and International Activities by Domestic 501(c)(3) Organizations: Request for Comments Regarding Possible Changes

Announcement 2003–29

The Internal Revenue Service requests public comment on how it might clarify existing requirements that section 501(c)(3) organizations must meet with respect to international grant-making and other international activities. The IRS is particularly interested in comments on how new guidance might reduce the possibility of diversion of assets for non-charitable purposes while preserving the important role of charitable organizations world-wide.

Background

The attacks of September 11, 2001, focused public attention on the need to take comprehensive measures to prevent terrorism. Investigative and law enforcement initiatives have identified situations in which charitable organizations have been a significant source of terrorist funding. The financing has come not only from United States-based charitable organizations, but also from foreign organizations that receive support directly or indirectly from United States donors. Further, investigative efforts have also identified situations in which diversion of charitable assets occurred without the knowledge of donors.

Statement of Purpose

The IRS is evaluating current guidance with respect to international grant-making and international activities of United States-based charities (both public charities and private foundations) to determine whether and to what extent additional guidance is needed to help prevent the diversion of charitable assets for non-charitable purposes and to assure donors that donations are used for their intended charitable purpose.

Guidance addressing standards, controls, and reporting requirements for international giving by U.S. charities has focused more on reducing the risk that charitable assets might be diverted for personal gain. The IRS is concerned that this guidance does not adequately cover the measures charities

should take to protect funds from being used for other non-charitable purposes (including terrorist activities). As a result, the IRS is considering new guidance applicable to public charities and private foundations that clarifies standards and requirements for international grant-making and international activities. The IRS is also considering making revisions to Forms 990, 990-PF, and 1023 to provide for more specific reporting on international grant-making and international activities.

The IRS is interested in learning how domestic charitable organizations conduct their international grant-making and international activities, and receiving suggestions on how existing guidance could be expanded to better address compliance with section 501(c)(3) and other federal tax standards. The IRS is particularly interested in comments on how the existing rules might be improved to help preclude the diversion of assets for non-charitable purposes and assure donors that their contributions are used solely for charitable purposes.

Within the past year, the IRS has issued three other requests for comments that could bear on international grant-making and international activities of charities. In Announcement 2002–87, 2002–39 I.R.B. 624, the IRS asked for public comments on how, among other matters, Form 990 might be improved to better reflect international grant-making activities of exempt organizations. In Announcement 2002–92, 2002–41 I.R.B. 709, the IRS asked for comments on changes to Form 1023. In Announcement 2002–47, 2002–18 I.R.B. 844, the IRS asked for comments on changes to private foundation regulations. The comment period has closed for all three requests. The IRS is aware that members of the public submitted comments in response to those requests that would also be responsive to this request and will take those comments into consideration. However, you may wish to modify or expand those comments to address the specific considerations raised here.

Existing Law

Section 501(a) of the Internal Revenue Code provides for exemption from income tax of organizations described in section 501(c)(3). Section 501(c)(3) describes organizations that are organized and oper-

ated exclusively for religious, charitable, scientific, educational, or certain other specified purposes.

Section 170(c)(2) of the Code provides that the term “charitable contribution” includes a contribution or gift to a domestic organization that is organized and operated exclusively for religious, charitable, scientific, educational, or certain other specified purposes.

Rev. Rul. 71–460, 1971–2 C.B. 231, provides that a domestic organization that conducts some or all of its activities outside the United States is not precluded from qualifying for exempt status under section 501(c)(3). See also Rev. Rul. 68–117, 1968–1 C.B. 251, and Rev. Rul. 68–165, 1968–1 C.B. 253.

Rev. Rul. 68–489, 1968–2 C.B. 210, provides that an exempt organization under section 501(c)(3) does not jeopardize its exempt status by distributing funds to organizations not themselves exempt under section 501(c)(3), provided the exempt organization:

- 1) retains control and discretion as to the use of the funds;
- 2) maintains records establishing that the funds were used for section 501(c)(3) purposes; and
- 3) limits distributions to specific projects that are in furtherance of its own exempt purposes.

Rev. Rul. 56–304, 1956–2 C.B. 306, provides that an organization is not precluded from section 501(c)(3) exemption when it makes grants to individuals, provided the distributions are made on a true charitable basis and in furtherance of its exempt purposes. Such organizations should keep adequate records and case histories to show:

- 1) the name and address of the recipients;
- 2) the amount distributed to each;
- 3) the purpose for which the aid was given;
- 4) the manner in which the recipient was selected; and
- 5) the relationship, if any, between the recipient and

(i) members, officers, or trustees of the organization;

(ii) a grantor or substantial contributor to the organization or a member of the family of either; and

(iii) a corporation controlled by a grantor or substantial contributor.

For private foundations, section 4945 and its underlying regulations impose an excise tax on certain distributions. If a grant is made to another organization that is not a public charity, the excise tax of section 4945 will apply unless the foundation exercises expenditure responsibility with respect to that grant. Expenditure responsibility, as defined in section 4945(h) and the regulations thereunder, means that the foundation must exert all reasonable efforts and establish adequate procedures (1) to see that the grant is spent solely for the purpose for which made, (2) to obtain full and complete reports from the grantee on how the funds were spent, and (3) to make full and detailed reports to the IRS with respect to these expenditures. Section 4945 imposes other specific requirements that private foundations must meet when making grants to an individual in order to avoid making a taxable expenditure.

Rev. Rul. 63-252, 1963-2 C.B. 101, and Rev. Rul. 66-79, 1966-1 C.B. 48, provide guidance as to whether and under what circumstances gifts to domestic charities that subsequently transfer the gifts to foreign organizations are deductible by donors.

Issues for Comment

The IRS requests comments on how domestic charitable organizations conduct their international grant-making and international activities, and whether the existing guidance discussed above provides adequate federal tax standards for these activities. The IRS is particularly interested in comments on how the existing rules discussed above might be improved to help preclude the diversion of assets for non-charitable purposes. While the IRS welcomes all ideas, some possible areas to address are:

1. What specific practices and safeguards are currently used by public charities and private foundations to ensure that grants to foreign recipients are not diverted for nonexempt purposes and overseas activities are in furtherance of exempt purposes? The IRS would find it particularly helpful to have specific details about the grant-making process, and examples of typical programs, including but not limited to:

a. What kind of due diligence investigation is done in advance of grant-making?

b. What provisions are used by grant agreements to ensure grants are used for their intended purpose?

c. What reports or other mechanisms are used to track the use of grant funds?

d. If a public charity or a private foundation makes repeated grants to the same foreign grantee, how often does it perform renewed due diligence on the grantee?

e. Are grant agreements, reports, and other significant correspondence written or accurately translated into English? Are grant funds disbursed by check? By electronic funds transfer? By cash?

2. In the aftermath of September 11, 2001, what review or changes in practice have organizations made to ensure that grants are not diverted to support terrorism or other non-charitable activities?

3. What difficulties have public charities and private foundations encountered in monitoring how international grants are actually used, or how international activities are conducted? Are there particular types of grants, recipients, or activities that are easier to monitor than others?

4. a. Are there additional requirements that should be added beyond those already specified in Rev. Rul. 56-304, Rev. Rul. 63-252, Rev. Rul. 66-79, and Rev. Rul. 68-489 to reduce the risk that charitable assets may be diverted to non-charitable purposes? Please also comment on how any burden associated with any new requirements might be mitigated.

b. What specific changes to Forms 990, 990-PF, and 1023 would you recommend to allow for better monitoring of international grant-making and international activities by the IRS, and by other government agencies and members of the public who can review these forms as public documents?

5. In November 2002, the Treasury Department released "Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities" (search at www.treas.gov). These guidelines were developed to help a charity reduce the risk that the charity's funds would be frozen in connection with any ongoing anti-terrorism investigation. Recognizing that some of these voluntary best practices impose additional burdens on charities and may not be directly related to tax administration, the IRS is nevertheless interested in learning which of the best practices specified in the guidelines organizations currently use. The IRS is also interested in learning whether these currently used best practices are useful in achieving compliance with federal income

tax requirements and appropriate for other public charities and private foundations to follow.

How to Comment

Public comments should be submitted in writing on or before July 18, 2003, and should include a reference to Announcement 2003-29.

Comments may be submitted to:

Internal Revenue Service
Attn: T:EO:RA:G
(Announcement 2003-29)
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Comments may be hand delivered between the hours of 8 a.m. and 4 p.m., Monday through Friday, to:

T:EO:RA:G (Announcement 2003-29)
Courier's Desk
Internal Revenue Service
1111 Constitution Ave, N.W.
Washington, DC 20224

Comments may also be sent via e-mail to: Tege.eo2@irs.gov

All comments received will be subject to public inspection.

Drafting Information

The principal author of this announcement is Robert Fontenrose of the Exempt Organizations Technical Division. For further information regarding this announcement, contact Mr. Fontenrose at (202) 283-9484 (not a toll-free call).