EMERGING LEGAL ISSUES
IN
INTERNATIONAL PHILANTHROPY

I. The Recent Expansion of International Grantmaking by U.S. Foundations

International giving by U.S. foundations has increased dramatically over the past decade. This growth is reflected not only in the total dollar amounts granted for use abroad, but also in the number of U.S. foundations active in the international arena and the number of grants made. A recent report by The Foundation Center in cooperation with the Council on Foundations indicates that, from 1990 to 1998, the amount of international giving by all U.S. foundations grew from an estimated $764.5 million annually to $1.6 billion annually.\(^1\) The total amount granted increased 57 percent in actual dollars, or 43 percent adjusted for inflation, between 1994 and 1998.\(^2\) In 1994, 50 percent of the foundations sampled by The Foundation Center reported making international grants.\(^3\) From then until 1998, the number of U.S. foundations making international grants increased.

\(^{1}\) International Grantmaking II: An Update on U.S. Foundation Trends (New York: Foundation Center, in cooperation with the Council on Foundations, 2000), p. 16, hereinafter sometimes referred to as “the Foundation Center Report.” The term “international grantmaking” as used herein includes both direct grants overseas and grants to U.S. charities which then regrant the funds overseas.

\(^{2}\) Id., p. xiv.

\(^{3}\) Id. To collect the data reported in International Grantmaking: U.S. Foundation Trends (New York: Foundation Center, in cooperation with the Council on Foundations, 1997) the predecessor to International Grantmaking II, the study analyzed grants of $10,000 or more authorized or paid by 821 family, corporate and community foundations in 1990 and 1,020 such foundations in 1994. Grants of $10,000 or more authorized by 1,009 foundations in 1998 were analyzed for the update report, International Grantmaking II.
international grants rose 20 percent.\textsuperscript{4} International grantmaking averaged growth of
over nine percent per year from 1994 to 1998, after adjustment for inflation, relative to
the total number of grants made, with the number of international grants growing faster
than the total number of grants made by U.S. foundations during the same period.\textsuperscript{5}

Foundations grew in the late 1990s largely as a result of the booming U.S.
economy and strong stock market. International giving grew as a result of the
government’s diminished role in overseas funding coupled with globalization and
increased immigration to the United States, which have brought to the attention of U.S.
grantmakers both urgent needs abroad and their impact on the United States itself.
Drug-resistant infectious diseases are rampant and respect no borders, victims of ethnic
conflicts and natural disasters require humanitarian assistance, global warming and
other environmental problems can be effectively addressed only on a planet-wide scale,
and the fall of the Soviet Union and end of the Cold War have given birth to fragile
democracies in Central and Eastern Europe, which several U.S. grantmakers (including,
notably, the Soros Foundation Network) are nurturing. The rapid expansion of
international travel and trade, and global economic integration, have increased the
interdependence of countries around the world and awareness that widespread and
complex problems can be effectively addressed only globally. As new markets have
opened up, corporate giving has increased. Local businesses have become first

\textsuperscript{4} Id.
\textsuperscript{5} Id., p. 18.
national and then international, and their corporate grantmaking programs have increased support for the communities abroad in which they have offices or conduct business. Impoverished populations do not produce strong consumer bases. Politically unstable nations do not provide the stability needed for continued viability of U.S. corporations operating abroad. Thus, the spread of enlightened self-interest in the corporate sector.

Governments of post-industrialized countries have been and continue to be the primary donors supporting international development and relief. Government support has decreased substantially since the end of the Cold War, though. Between 1992 and 1997, the GNPs of the leading industrialized countries jumped almost 30 percent, but their funds allocated to international development and relief decreased by 30 percent. Many of the world’s poorest countries pay far more for defense and for interest on their debts to foreign investors and governments of post-industrial countries than they pay for education, health care and other basic human services. A recent study released by the United Nations Children’s Fund reported that the world’s poorest nations slipped further behind developing and developed nations during the 1990s. Statistics indicate that the majority of the world’s population subsists on $2 per day, and 1.5 billion people live in


7 Id.

abject poverty. The income gap between the richest fifth of the world’s population and the poorest fifth is 74 to 1.⁹ As governments of post-industrial nations have decreased their international development and relief efforts, corporations have increased their multinational aid.

Private foundations have also responded to the decrease in government funding. Currently, only 11 percent of all U.S. foundation grants, and less than two percent of all U.S. philanthropy, goes overseas.¹⁰ However, recent statistics indicate that there has been enormous growth in international funding since the mid-1990s, and the percentage of foundation money dedicated to projects overseas is expected to continue to grow. The Foundation Center study sampled independent family foundations, corporate foundations and community foundations. Among family foundations, five of the most active international funders ranked among the 100 largest U.S. foundations by grant amount. These included the Ford, W. Alton Jones, Rockefeller, Freeman and John D. and Catherine T. MacArthur foundations.¹¹ Of the 1,020 foundations sampled, 85 gave at least one-fourth of their grant dollars internationally, and 27 gave at least one-tenth.¹² The most active international grantmakers ranged from some of this country’s oldest

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⁹ “Five Reasons to Give Internationally,” supra at note 6.


¹² Id., p. 24.
modern foundations to some of the newest. The youngest foundations made more international grants as a proportion of their total giving. Twenty-two of the 36 foundations that gave at least 50 percent of their grants for international use were formed after 1970, and four of those since 1990. Almost half of the foundations that gave 25 percent or more of their grant funds internationally were younger foundations formed since 1970. Only 20 percent of the foundations that gave 25 percent or more of their grant funds internationally were created before 1950.\(^\text{13}\) Newer foundations are expected to make more international grants as their endowments and staff grow over the coming years. The Foundation Center report indicates that these foundations will be a significant factor in the future growth of international giving. Family foundations already account for 90 percent of the total amount of U.S. foundation grants for overseas programs. New mega-foundations such as the Bill & Melinda Gates Foundation and the David and Lucille Packard Foundation have made substantial international grants, but older foundations, such as the Ford Foundation, have also contributed enough dollars to have a material impact on the regions and causes receiving the most U.S. support.\(^\text{14}\)

Corporate foundations and community foundations have increased their international gifts at an even faster pace than family foundations. From 1994 to 1998,
international grants by corporate foundations increased over 120 percent, to $57 million, while giving by community foundations grew over 150 percent, to $6 million.\textsuperscript{15}

A strong U.S. economy and stock market, combined with the opening of new markets and increasing globalization of business, led to a huge jump in international grants by corporate foundations, which more than doubled from 1994 to 1998, outpacing by rate of growth all other corporate grants.\textsuperscript{16} The Foundation Center study assessed corporate grants only through corporate foundations. The study also revealed that corporations make the majority of their overseas grants either through their foreign affiliates or through direct giving programs, rather than through their foundations.\textsuperscript{17} Thus, international grants by corporate foundations included in the Foundation Center report represented only a small percentage of corporate giving overseas. If a U.S. corporation has subsidiary operations abroad, it is simplest for the foreign subsidiary to make a contribution to a charity established in the country in which the subsidiary operates. The overseas subsidiary will then claim whatever tax benefits are available under that country’s laws. A charitable deduction or, quite frequently, a business expense deduction, is claimed against the subsidiary’s foreign income tax owed to the country in which it is located, and U.S. tax laws are not involved.

\textsuperscript{15} Id., p. 17, Table 2-2 and p. 19, Table 2-3.
\textsuperscript{16} Id., p. 19.
\textsuperscript{17} Id., p. 3.
The number and size of U.S. community foundations also saw rapid growth in the 1990s. By their very nature, community foundations are formed primarily to support the geographic areas in which they are situated. However, they are playing an increasing role in international gifting. From 1994 to 1998, the number of community foundation grants for use abroad grew almost 200 percent, with the dollar value surging from $2.4 million to $6.3 million. This trend is expected to increase as the number of community foundations increases in jurisdictions around the world and as partnerships among U.S. and foreign community foundations multiply and develop.

The numbers confirm the author's conclusion, based on her practice in international philanthropy, that a new awareness of global interconnectedness has developed in the post-Cold War era. A 1982 report on international grantmaking noted:

. . . a fundamental obstacle to increased international philanthropy is a pervasive lack of knowledge or understanding among United States citizens of the interdependence of the United States' social, economic and political well-being with that of the rest of the world. Many of the grantmakers interviewed consistently saw “domestic” and “international” issues as mutually exclusive spheres.

18 Id., p. 17, Table 2-2, and p.19, Table 2-3.
Now grantmakers are increasingly recognizing that “the interplay between international and local events requires that foundations actively identify, monitor and respond to international events and trends affecting their local interests.” The Foundation Center study reports that, while many foundations still distinguish between domestic and international grants, almost one-third of the foundations sampled in 1998 organized their grantmaking thematically, with no distinction between domestic and international grants.

A number of foundations are funding programs to educate Americans about the role of the U.S. in a globalized world. As noted above, several factors have led to this growing awareness among U.S. grantmakers and have facilitated international grantmaking:

• Partnerships between U.S. foundations and foreign nongovernmental organizations (NGOs) are on the rise.

• Numerous conferences have been held around the world in recent years to focus attention on global issues and facilitate dialogue among donors, business leaders, NGOs and development specialists, leading to attempts to formulate and

22 Id., p. 7.
disseminate “best practices” in overseas giving as well as to educate attendees about policy and procedural matters.

- Several international philanthropic networks have been established, allowing grantmakers to share their knowledge and experience.

- The internet has simplified research in connection with overseas grants; and the legal requirements for U.S. foundations making grants for use abroad are slowly but surely being clarified and somewhat simplified.\(^{23}\)

Adding to this, wealthy immigrants to the U.S. have begun establishing foundations that provide funding for projects in their homelands and are also establishing donor advised funds at local community foundations to support such projects.\(^{24}\)

This increased awareness of globalization by U.S. donors has, for example, resulted in more grants for research on diseases that typically strike Third World populations so are not profitable for U.S. pharmaceutical companies. A recent story reporting that research on cures for malaria and tuberculosis has received major funding from the Bill & Melinda Gates Foundation, the National Institute of Health and Britain’s Wellcome Trust, quotes Alfred Sommer, dean of the Bloomberg School of Public Health at Johns Hopkins University, as commenting: “What’s not new is the

\(^{23}\) See, e.g., *International Grantmaking II*, pp. 8-11.

\(^{24}\) Id., p. 12; Carson, *Grantmaking for the Global Village*, p. 18. As Carson notes, these donor advised funds have led to increased community foundation involvement in international philanthropy.
severity of the diseases. What is new is the sudden urgency and interest on the part of donors.25 Another example of this growing global awareness is that some community foundations near the Mexican border have started making grants for use in Mexico, in order to address such issues as disease brought in by immigrants, and pollution, which affects the quality of life in U.S. states adjacent to Mexico as it crosses the border. Janice Windle, Executive Director of the El Paso Community Foundation, which makes grants involving Mexico, has noted: “While it looks like we are acting very heavily in the international arena, in reality we’re just dealing with our daily lives.”26

These increases in international grantmaking are encouraging, but such grants remain only 11 percent of total grantmaking by U.S. foundations.27 Factors inhibiting greater cross-border giving are that U.S. tax rules governing such grants are quite complex and intimidating, there is inadequate guidance for grantmakers as to what constitutes compliance with those rules, and few lawyers, accountants and other allied professional advisors are well-versed in the applicable requirements.

II. Technical Requirements and Impediments for Foundations Making International Grants

International funding by U.S. family foundations can be effected by means of direct grants to overseas organizations or grants to U.S.-based groups which support

26 Carson, Grantmaking for the Global Village, p. 4.
projects abroad. This is largely a function of applicable U.S. tax laws. Private nonoperating foundations are generally required to make annual “qualifying distributions” equal to at least five percent of their net investment income after a brief start-up period.\textsuperscript{28} The rules governing when a direct grant to a foreign organization qualifies as part of the mandatory annual distributions are complex, unwieldy and expensive to implement. The private foundation that wants to avoid dealing with the stringent requirements applicable to direct grants abroad may instead choose to make its grant to a U.S. public charity that will use the funds to support a charitable project overseas. This is common for smaller foundations, which lack the staff to process direct overseas grants and the funds for consultants to guide them in making such grants.

The Foundation Center study reports that, from 1990 to 1998, direct funding overseas experienced enormous growth. Grants to both overseas and U.S.-based programs for use abroad continued to grow rapidly, in terms of both total dollars granted and number of grants made. In the first half of the decade, foundations made more direct overseas grants than grants to U.S. charities operating and/or funding projects abroad. However, in the second half of the decade, funding of U.S.-based international programs outpaced direct overseas support. From 1994 to 1998, amounts granted to U.S.-based international programs grew 65 percent, while amounts granted directly overseas grew 47 percent.\textsuperscript{29} The study found that new and newly international

\textsuperscript{28} IRC Section 4942.

\textsuperscript{29} International Grantmaking II, p. 44.
foundations tended to make such grants through domestic intermediaries, as did smaller and mid-sized funders. The older and larger grantmaking foundations tended to distribute substantially more of their international grants directly to overseas organizations.\(^{30}\) Still, most grants for use abroad are made through U.S. public charities which act as intermediaries and regrant the funds overseas.\(^{31}\)

A. Use of U.S. Intermediaries

U.S. public charity intermediaries are widely used because their use relieves the granting foundation of substantial responsibility for compliance with Internal Revenue Code (IRC)\(^{32}\) rules aimed at ensuring that the granted funds are used for charitable purposes within the ambit of IRC Section 170(c). Grants to domestic public charities are generally qualifying distributions. Therefore, if a private foundation makes its grant to a U.S. public charity that is willing to regrant the funds for use abroad, the foundation does not have to comply with the stringent and frequently complex requirements applicable to direct overseas funding.

Several types of U.S. public charities may receive foundation grants for use abroad. A number of U.S. public charities have a foreign branch office or subsidiary. Even if the grant is to be used by that foreign office or subsidiary, it is treated for tax purposes as made to the U.S. charity since the foreign branch or

\(^{30}\) Id., pp. 45-47.

\(^{31}\) Id., p. 52.

\(^{32}\) All references to the IRC are to the Internal Revenue Code of 1986, as amended.
subsidiary is subject to complete administrative control by its U.S. parent. Many U.S. charities, such as Oxfam, CARE and the Red Cross, have broad-based direct programs abroad. It is possible for a foundation to specify that its grant is to be used for a particular overseas program of the grantee U.S. public charity as long as that program is subject to total control by the grantee.

In addition, a U.S. public charity may be formed exclusively to support one or more foreign organizations. Contributions to a U.S. public charity intermediary must be made for exclusively charitable purposes and must not be "earmarked" for distribution to a foreign grantee organization. For this reason, such U.S. organizations may not serve as mere conduits, merely funneling earmarked donations to non-U.S. charities. Revenue Ruling 63-252 addresses the deductibility of contributions by individuals to a U.S. charity which then transmits some or all of its funds to a foreign charity. No deduction is permitted unless the U.S. organization reviews and approves the charitable purpose of the grant as being in furtherance of its own charitable purposes. The IRS has enumerated several additional procedures to be followed by U.S. public charities which make grants to foreign charities. These procedures are


34 See Rev. Rul. 63-252, Ex. 4. Also see Victoria B. Bjorklund and Jennifer I. Goldberg, "How a Private Foundation Can Use ‘Friends Of’ Organizations," International Dateline, August 1998, Issue 48 (Council on Foundations). U.S. public charities specifically formed to support foreign organizations are sometimes referred to as “friends of” organizations because they often bear names such as American Friends of Oxford University.
intended to ensure that the U.S. charity retains sufficient discretion and control over the use of such grants to ensure that the funds are used solely for charitable purposes.\textsuperscript{35}

Community foundations can also facilitate overseas gifts if their governing instruments do not include geographic restrictions which preclude grants abroad. Overseas grants through U.S. community foundations are usually effected by means of contributions to donor advised funds, with the private foundation’s board acting as the donor advisor.\textsuperscript{36}

B. IRS Recognition of Foreign Charities

A foreign charity may apply to the IRS for recognition as an organization exempt from taxation under IRC Section 501(c)(3). However, relatively few non-U.S. charities apply. One disincentive to such applications is that, even if the foreign charity has obtained IRS recognition, direct contributions from U.S. individual donors still cannot be deducted against income tax liability because the organization is not formed in the United States. Legal costs and complicated ongoing reporting requirements (including U.S. information returns for each year in which the foreign charity has more than $25,000 of U.S.-source income) are also disincentives.


Although IRS recognition of a foreign charity does not qualify donations to it for U.S. income tax deductions, it does offer important benefits to the foreign charity. U.S. private foundations can make grants to such a foreign charity without worrying about the requirements of an equivalency determination or expenditure responsibility (both discussed below). Grants from U.S. public charities to foreign charities with IRS determination letters also do not require ongoing monitoring by the grantor. Therefore, foreign charities that want to receive funds from U.S. charities should consider going through the application process. However, most foreign charities do not obtain IRS recognition, and a complex set of rules governs the process of making grants to those organizations in order to ensure that grant funds are expended for solely charitable purposes.

C. Rules Governing Grants Abroad by Private Foundations

Private nonoperating foundations making grants abroad will want to determine whether the foreign grant counts as a "qualifying distribution" for purposes of the IRC Section 4942 minimum distribution rules and to avoid running afoul of the IRC Section 4945 prohibition against grants to organizations other than public charities unless the grantor exercises "expenditure responsibility."

If a private foundation fails to make sufficient qualifying distributions annually of amounts equal to five percent of the aggregate fair market value of all of its
assets held for investment, it will be subject to an excise tax in that year. The taxable expenditure provisions of IRC Section 4945 also have a substantial impact on grants abroad by private foundations. A private foundation makes a taxable expenditure subject to excise tax if it makes a grant (i) for any purpose other than one specified in IRC Section 170(c)(2)(B) or (ii) to an organization that is not a public charity (or foreign equivalent of a U.S. public charity) unless the private foundation exercises “expenditure responsibility” with respect to the grant.

1. **Good Faith Determination.** A grant by a U.S. private foundation to a foreign organization that has received an IRS determination letter that it is a public charity is always a qualifying distribution for purposes of the five percent minimum distribution rule. If the foreign donee does not have such a determination letter, the private foundation will generally first try to make a "good faith determination" that the donee is the equivalent of a U.S. public charity. If this determination can be made, the foreign grant will be a qualifying distribution even if the U.S. grantor does not exercise the ongoing monitoring of the funded project known as “expenditure responsibility.”

In making a good faith determination, the private foundation may rely on an opinion from its counsel or the grantee's counsel or an affidavit of the grantee. However, if this method is used, each potential U.S. grantor private foundation must obtain its own lawyer equivalency letter or grantee affidavit, and the

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37 I.R.C. §4942.

cost may be prohibitive for smaller foundations. In Revenue Procedure 92-94,\textsuperscript{39} the IRS approved a form of equivalency affidavit of the foreign grantee that may be relied upon by multiple U.S. grantors as long as it contains current information. This helps small foundations make their good-faith determinations at a reasonable cost.

2. \textit{Expenditure Responsibility}. If the private foundation cannot determine that the proposed foreign donee organization is the equivalent of a U.S. public charity, then the grantor private foundation must exercise “expenditure responsibility” over the grant. Exercising expenditure responsibility entails making a pre-grant inquiry to allow the grantor to make a reasonable determination that the proposed grantee can fulfill the charitable purpose of the grant. An officer or director of the foreign grantee must also sign a written grant agreement specifying the charitable purpose of the grant and committing the grantee to:

\begin{itemize}
  \item a. repay any funds not used for the grant's purpose;
  \item b. submit annual reports detailing how the funds have been used, compliance with the grant agreement and the grantee's progress in achieving the purpose for which the grant was made (these grantee reports must usually be made until all of the grant funds have been expended);
  \item c. maintain books and records which are made reasonably available to the grantor; and
\end{itemize}

d. refrain from using any of the funds for lobbying, direct or indirect influence on any public election or voter registration drive, or any activity for a noncharitable purpose, to the extent such use of the funds would be taxable to a private foundation.

The agreement will typically also prohibit the grantee from regranting the funds to other organizations or individuals since that triggers additional complicated rules. If the foreign grantee is not the equivalent of a U.S. private foundation, the agreement must also require the donee to maintain the grant money in a separate fund dedicated to charitable purposes so that the grantee may properly account for the funds.40

Special rules also address the situation where a director, trustee or employee of the U.S. grantor foundation becomes aware of or suspects diversion of grant funds by a foreign grantee to any use not in furtherance of any charitable purpose specified in the grant agreement. If that occurs, immediate follow-up may be required, and any future installments of grant funds may need to be suspended or cancelled. The grantor foundation may even have to take reasonable steps to recover funds already granted if it has evidence that the grantee has misused the funds.41

40 See Treas. Regs. §53.4945-5(c)(3)(ii), §53.4945-5(b)(8) and §53.4945-6(c).

41 Treas. Reg. §53.4945-5(e)(1).
The Treasury Regulations on expenditure responsibility recognize that “[a] private foundation is not an insurer of the activity of the organization to which it makes a grant.”42 The Regulations provide that the grantor foundation will not be found to have violated the taxable expenditure rules if it has followed the prescribed expenditure responsibility procedures, even if funds are in fact diverted by the grantee or something else goes wrong.43

The U.S. grantor private foundation must take all reasonable efforts to establish adequate procedures to see that the grant is spent solely for the purposes for which made and must obtain detailed annual reports from the grantee on how the funds are spent. It must also provide the IRS with annual reports on all expenditure responsibility grants.44 In order to satisfy its IRS reporting requirement, the grantor private foundation is required to provide information about each expenditure responsibility grant on its annual Form 990-PF information return.

3. **Grants to Governmental Units.** Grants to foreign governmental units do not require either an equivalency determination or expenditure responsibility. The Treasury Regulations provide that a foreign organization will be treated as a public charity if it is a “foreign government, or any agency or instrumentality thereof ... even if it

43 Treas. Reg. §53.4945-5(e).
44 I.R.C. §4945(h).
is not described in IRC Section 501(c)(3). 45 However, any grant to such a governmental unit must be for charitable, not public purposes. Therefore, the U.S. grantor foundation should obtain documentation establishing that the grantee is a foreign government or governmental unit, and it should enter into a grant agreement obligating the grantee to use the grant for charitable purposes.

4. The “Out of Corpus” Requirement. IRS rules specify that one private foundation cannot make grants to endow another. A grant from one private foundation to another (whether overseas or domestic) will not meet the definition of a qualifying distribution for purposes of application of the five percent minimum payout rules to the grantor unless the grantee satisfies the so-called "out of corpus" rule. 46 For this reason, if the foreign charity grantee is the equivalent of a U.S. private foundation, the U.S. foundation's grant to it must also meet the out of corpus requirement. The out of corpus rule requires that any grant from one private foundation to another must be spent by the grantee within 12 months after the close of the taxable year in which it received the funds. The grantee must take the grant funds "out of corpus" and spend them within the required amount of time. This policy is designed to ensure that such private foundation grants will be used for the public benefit and not to build the recipient organization's investment portfolio.

46 Treas. Reg. §53.4942(a) - 3(c).
Furthermore, the grantee foundation must provide records to the grantor foundation showing that the grantee met its minimum payout requirement before it received the grant, and the grantee satisfied its minimum payout requirement for the year in which the grant was received in addition to spending the grant. Since most foreign charities are unfamiliar with the minimum payout rules and do not maintain the records necessary to compute it, satisfying the out of corpus requirement frequently will not be possible.47

The procedure approved by the IRS in Revenue Procedure 92-94 has helped simplify the process of collecting the data necessary to attempt to make a “good faith determination” that a proposed foreign grantee is the equivalent of a U.S. public charity, and it has also potentially decreased the cost of that process because several U.S. grantors may rely on a single currently qualified Revenue Procedure 92-94 affidavit. However, the process is still generally expensive and often impossible. The affidavit requires the grantee to provide its governing documents and local law translated into English. Moreover, the grantor must obtain and review several years’ financial data of the grantee in order to try to determine whether it meets the public support test applicable to U.S. public charities. As a practical matter, grantees in underdeveloped nations do not readily or easily provide such data. Even when they do, differences between U.S. law and the law of the grantee’s jurisdiction may make it very

time-consuming for the grantor, or more often its counsel, to tell whether, for example, the grantee’s assets are required to be distributed to other charities upon dissolution of the grantee, or whether private inurement, private benefit and substantial lobbying and political activities are prohibited. Even if the grantor is able to clear all of these hurdles, it will still need sufficient staff capacity to exercise the required ongoing oversight, and grantors can become quite frustrated chasing financial reports and other follow-up data needed for expenditure responsibility grants.

In addition to the complex maze of IRC requirements, other laws may impede a foundation’s ability to make cost-effective grants abroad. Grants to organizations in embargoed countries are a good example of situations requiring substantial legal advice which is cost prohibitive for most small to mid-sized foundations. Counsel to such grantors must have working knowledge of rules imposed by the embargo, exceptions to the embargo and how to obtain necessary government permission or licenses to make such grants.

For a discussion of differences in the laws governing NGOs in various jurisdictions, see Karla W. Simon, “Dissolution Dos and Don’ts.” Also see Simon’s “Legal and Regulatory Frameworks for the Not-for-Profit Sector: A Comparative Analysis.” Both are available in the International Center for Not-for-Profit Law website: www.icnl.org.

III. Recent Developments in Technical Requirements for Overseas Grants

Some foundations avoid making grants to overseas organizations because they are concerned about possible failure to comply with all of the requirements for expenditure responsibility.\textsuperscript{50} Sometimes, the U.S. foundation lacks adequate staff to comply, and sometimes it lacks funds for professional counsel in connection with such grants. The author has also helped arrange for community foundations to facilitate international grants by acting as intermediary, where the size of the grant or the frequency with which the foundation anticipates making international grants does not warrant the grantor’s developing the forms, policies and procedures needed to administer expenditure responsibility grants. Particularly during the last decade, several efforts have been made to simplify the applicable procedures. This section describes the outcomes of those of such efforts which have succeeded to one degree or another.

A. “Good Faith Determinations”

A U.S. foundation wishing to make a grant to a foreign organization has traditionally first attempted to make a good faith determination that the grantee is the equivalent of a U.S. public charity and has then resorted to expenditure responsibility only if that determination could not be made. This has been an expensive and time-consuming process in many cases, particularly when laws governing NGOs in the country of the proposed grantee are not similar to U.S. laws governing nonprofits. As

noted above, in order to attempt a good faith equivalency determination, the grantor must review the grantee’s governing documents, analyze local governing law and review several years’ financial data of the grantee. Often the governing documents must be translated and the financial data, if available at all, converted to U.S. currency. If the proposed foreign grantee is a hospital or school, the grantor must also obtain and review patient admission and student racial discrimination policies and standards. In collecting the necessary data, each U.S. grantor to the same foreign grantee has typically had its own counsel collect and analyze this data and then, where possible, issue a letter opining that the grantee is the equivalent of either a U.S. public charity (in which case no expenditure responsibility is required) or a U.S. private foundation (in which case the grantor must exercise expenditure responsibility, and the grant must satisfy the out of corpus rule). The process of obtaining the legal opinion has been prohibitively expensive for some grantors.

1. Revenue Procedure 92-94

In 1992, the IRS issued Revenue Procedure 92-94,\textsuperscript{51} which provided a form of “equivalency affidavit” which may be relied upon by multiple U.S. grantors to the same foreign organization as long as it is current or has been updated by the foreign grantee to include current data. While the Revenue Procedure’s approach is an admirable attempt to simplify the process of international grantmaking by U.S. foundations, the author has found it to be of little utility. There is no central

\textsuperscript{51} Supra, note 39.
repository for Revenue Procedure 92-94 affidavits (although the International Center for Not-for-Profit Law is building one on its website), so use by multiple grantors most often depends on fortuitous communications among them. Occasionally, a grant application from a foreign grantee is referred by a larger U.S. foundation to a smaller one, and the latter is given access to an affidavit obtained by the referring foundation, along with supporting materials. Even then, the smaller foundation will be hesitant to rely on its own analysis of the data, or even on the analysis performed by or for the larger foundation, and will therefore still incur the expense of having its counsel analyze the data and issue an opinion regarding equivalency. Thus, while the process approved by the Revenue Procedure has promise and may save substantial time and costs once such a central database is available, it has limited utility as a cost and time saver at this point. Its primary benefit, in the author’s experience, has been to provide foundations with IRS-approved forms of an equivalency affidavit and financial schedules designed to elicit the necessary information from the foreign grantee.

2. IRS General Information Letter on Equivalency Determination

Following a two-year effort by the Council on Foundations, on April 18, 2001, the Department of the Treasury issued a general information letter that will streamline overseas grantmaking. The letter, which may be relied upon by all U.S. private foundations, indicates that foundations do not need to attempt to make a good

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faith determination that a proposed foreign grantee is the equivalent of a U.S. public charity before deciding to make the grant subject to expenditure responsibility. This is a welcome development because the equivalency determination process is so complex, costly and time-consuming. It will be particularly helpful where the foreign organization is unable to provide the financial data needed to determine whether it meets the U.S. charity public support test. The letter was needed because the IRC and applicable Treasury Regulations seemed to indicate that an equivalency determination had to be attempted before the U.S. grantor foundation could make an overseas grant subject to expenditure responsibility. Treasury has now provided this guidance and confirmed that the Regulations do not, in fact, require this.

The letter makes clear that a U.S. private foundation may treat an overseas grantee as a non-charity from the outset. It also notes that a private foundation is not bound by another private foundation’s determination regarding whether the same grantee is the equivalent of a U.S. public charity. Moreover, unless the foreign grantee has applied for and received an IRS determination letter, the IRS will respect the grantor foundation’s conclusion that the grantee is either the equivalent of a U.S. private foundation or a non-charity. The letter does not affect specific treaty rules, such as those under our treaties with Mexico and Canada. The April 18, 2001 letter should encourage international grantmaking by U.S. foundations by meaningfully streamlining the due diligence process.
B. Regranting of Expenditure Responsibility Grant Funds

When a U.S. private foundation makes an overseas grant, stringent requirements often apply if the foreign grantee will regrant the funds to other organizations or to individuals. Regranting can be attractive because foreign grantmaking organizations have better access than U.S. grantors to information regarding which local projects are the best and most effective. For this reason, a U.S. donor foundation may make a grant to a foreign entity (the initial grantee) which in turn regrants the funds to other local entities or individuals (secondary grantees). If the initial grantee is a U.S. public charity equivalent, the U.S. grantor is not required to monitor the regranting. If not, however, the secondary grant must comply with all of the normal requirements for grants by U.S. private foundations.\(^53\) A secondary grant to an individual must be made on an objective and non-discriminatory basis, and according to procedures pre-approved by the IRS. If the secondary grant is to a foreign organization that is not the equivalent of a U.S. public charity, the initial grantee must exercise expenditure responsibility as to the grant. These requirements have raised concerns that the U.S. grantor must somehow guarantee the initial grantee’s compliance with these rules.\(^54\)


In 1997, the IRS issued a private letter ruling that answered a lot of questions about a U.S. donor’s responsibility with respect to such secondary grants. The ruling takes a pragmatic approach which does not hold the U.S. grantor responsible if the initial grantee fails to meet all requirements of exercising expenditure responsibility over the secondary grant. Specifically, the ruling held that:

(i) the U.S. grantor’s expenditure responsibility requirements regarding the secondary grants are satisfied if the initial grantees are bound by written grant agreements to meet the applicable requirements in connection with the secondary grants, as long as the initial grantees also provide the grantor with satisfactory reports, the grantor has no reason to doubt the accuracy of those reports and the grantor properly reports the initial grants on its Forms 990-PF;

(ii) if the initial grantee makes a secondary grant to an individual, it may use procedures for which the U.S. grantor has received pre-approval from the IRS; and

(iii) the initial grantee need not make reports to the IRS regarding the regrants even though, technically, a pledge to exercise expenditure responsibility entails proper reporting to the IRS.

The pragmatic approach taken by this ruling is a comfort to U.S. grantmakers. While U.S. grantors must still take care to comply with many technical

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requirements, the IRS has indicated that the grantor is not an insurer with respect to the proper exercise of expenditure responsibility by overseas initial grantees who make secondary grants of the funds.

C. New Tax Withholding Requirements for Certain Foreign Grants

On a less positive note, new Treasury Regulations under IRC Section 1441 may require U.S. foundations to withhold taxes on grants to foreign individuals or organizations.\textsuperscript{56} The new Regulations, which became effective on January 1, 2001, require U.S. foundations to withhold U.S. income taxes on grants they make to foreign individuals or organizations that perform all or a portion of the activities funded by the grant within the United States. The new rules do not affect grants that do not involve activity taking place within the United States, so will not affect most international grants. However, if grant funds will be used to allow a foreign individual to attend a conference in the United States, teach here, intern with a company here, or perform other activities here, or will allow a foreign entity to perform activities within the United States, withholding on the portion of the grant funds to be used for the U.S. activity will be required unless:

(i) the recipient qualifies under a treaty exception;

(ii) the recipient is an entity, and it can be proven that the recipient could qualify as a U.S. tax-exempt organization; or

\textsuperscript{56} Treas. Reg. § 1.1441-1(b).
(iii) the grant is intended to be used solely to acquire property.57

D. Trends in Technical Requirements

A cooperative effort to streamline and simplify procedures for international grantmaking has existed for several years. The Council on Foundation’s U.S. Giving Abroad Initiative grew out of its Strategic Plan for International Programs. The goal of the initiative is to facilitate communication and reporting procedures for overseas grantmaking by U.S. foundations.58 Initial planning for the initiative occurred at an October 1, 1996 meeting in New York called “Facilitating U.S. Giving Abroad: Current Solutions, Current Problems.” Representatives of 17 foundations attended the meeting, which was co-hosted by the Council on Foundations, the American Express Corporation and the International Center for Not-for-Profit Law.

The scope of the U.S. Giving Abroad Initiative is to share “best practices” among foundations that make overseas grants; explore much-needed revisions to IRS guidelines for cross-border grants; and collect in a central, readily accessible place, forms (such as Revenue Procedure 92-94 affidavits) and information about nonprofit law in various countries. The work of the Initiative’s Administrative/Legislative Task

57 A memorandum on these requirements can be accessed at the Council on Foundation’s website at: www.cof.org/legal/index.htm. The full text of the new Regulations is also available at that website.

Force on simplifying and clarifying procedural requirements is critical as international philanthropy grows. Many of the current rules were developed when such grants were rare, and in the same atmosphere of suspicion, and perhaps xenophobia, that gave rise to the U.S. law denying U.S. donors income tax deductions for direct gifts to foreign charities.59 The Task Force has identified as areas of concern the duration and level of reporting requirements for certain types of grants,60 the out of corpus rules, restrictions on regranting, and the rules governing equivalency determinations.

A task force of the Exempt Organizations Committee of the Section of Taxation of The American Bar Association is also focusing on suggesting revisions to the rules governing international grantmaking by U.S. foundations. While the project encompasses work on rules governing both domestic and overseas grantmaking, the Task Force will be working to clarify and simplify the rules governing expenditure

59 IRC §170(c) allows a U.S. individual donor an income tax deduction only for contributions to charities organized in the United States. Congress has justified this rule because, in its view, the U.S. derives no benefits from such gifts. In 1939, it expressed its reason for disallowing an income deduction for direct gifts abroad saying: “[When a contribution is made to a U.S. charity, the] government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare. The United States derives no such benefit from gifts to foreign institutions.” H. Rep’t. No. 1860, 75th Cong., 3rd Sess., pp. 19-20, 1939-1 C.B. (Part 2) 728, at 742.

60 For example, cross-border grants for the purchase of capital equipment or to build an endowment raise reporting issues because capital equipment and endowments typically have a useful life longer than the terms of the grant. Grantees must usually report annually to the U.S. grantor until all of the grant funds have been expended. The Treasury Regulations do not specify how long a foreign grantee must continue to make written reports to the U.S. grantor foundation when the grant is for the purchase of capital equipment or for endowment. See Treas. Regs. §§ 53.4945-5(b)(3) and 53.4945-6(c)(2). Moreover, no cases or IRS rulings to date have addressed this issue. A logical approach as to purchases of capital equipment is to require reports over the useful life of the equipment, based on IRC depreciation rules and generally accepted accounting principles. Grants for endowment are problematic because the life of an endowment is potentially permanent. Therefore, the grantee might have to report indefinitely, and the grantor would also have to continue reporting on the grant to the IRS. Clearly, guidance and safe harbors in these areas are much-needed.
responsibility, with a focus on reporting requirements and program-related investments.\(^{61}\) Program related investments (PRIs) are private foundation investments in ventures that help achieve the foundation’s charitable purposes.\(^{62}\) The Treasury Regulations on PRIs are very limited and offer examples that are often difficult to apply in a foreign context. The goal of the Task Force will be to flesh out guidance on the permissible terms of PRIs and the examples offered.

The projects discussed above are just a couple of the many current projects whose goals are to facilitate communication among NGOs around the world and to help governments, the private sector and NGOs to work together to solve communities’ needs by opening lines of communication, analyzing interaction among these sectors, and developing uniform best practices for international giving. For example, the Active Learning Network for Accountability and Performance in Humanitarian Assistance is working with other NGOs to establish universal codes of conduct in humanitarian assistance.\(^{63}\)

Community foundations around the world are also joining forces to promote and support the development of community foundations. For example,

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WINGS-CF, an informal network of community foundations around the world, helps its member organizations work with their peers to share information and experiences.\textsuperscript{64} Another current project of interest is the Community Foundation Transatlantic Fellowship program sponsored by the King Baudouin Foundation of Belgium and the United States (KBF) and the German Marshall Fund of the United States (GMF), with the support of the Charles Stewart Mott Foundation. During each year of the program, American and European senior staff representatives of community foundations are participating in the new peer exchange program for community foundation professionals. Participants spend three weeks at a host community foundation on the other side of the Atlantic to learn about the social, cultural, and other circumstances affecting the development of community foundations in a country other than their own. While at the host foundation, the community foundation senior staff members participate in day-to-day office operations; explore issues of governance, strategic planning, grantmaking, and investment; and learn about public/private partnerships. They are expected to hold informal briefings for their hosts on the needs and foundation practices in their own communities.\textsuperscript{65}


\textsuperscript{65} Interview with Joseph Lumarda, Executive Vice President, External Affairs, California Community Foundation (June 8, 2001). In the 1999 to 2000 inaugural year of the project, Mr. Lumarda visited with two Polish community foundations as a part of this project, and the California Community Foundation has hosted representatives of foreign community foundations who are visiting the United States as a part of this project. For more information on the project, go to \url{www.gmfs.org}.  

One of the reasons that equivalency determinations are so difficult and cumbersome is that laws governing NGOs vary widely among jurisdictions. Another complication for international grantmakers is that existing legal systems around the world are inadequate to support the development of solid, independent, transparent and responsible NGOs.\textsuperscript{66} Insufficient local regulation permits lack of accountability, which frequently results in fraud and diversion of funds.

Several cooperative efforts are afoot to educate various jurisdictions about each others’ not-for-profit laws, develop such legal structures where there are none or where they are in their infancy, and provide technical assistance in writing laws and regulations, while developing global standards and guidelines for best practices for incorporation into the laws governing NGOs in countries all over the globe. The International Center for Not-for-Profit Law (ICNL), in cooperation with the Council on Foundations, is developing a database of NGO laws of various jurisdictions which, when available on ICNL’s website, will be an invaluable resource for counsel performing equivalency determinations. The website already has this data available for some jurisdictions. Data on some other jurisdictions that are not yet available online can be obtained at no charge from ICNL.

The process of standardizing NGO laws globally is a fascinating one for counsel who participate. The author was fortunate to have the opportunity, in April of

1998, to meet for a day with a delegation from mainland China which was touring the world to discuss best practices and legal frameworks governing philanthropy. The delegation’s mission was to craft a statutory structure for philanthropy in China, including oversight of NGOs. Detailed discussions of U.S. practices regarding enforceability of pledges, U.S. laws forbidding private inurement and private benefit, and tax benefits for charitable contributions highlighted some vast cultural differences but also confirmed that many concerns about best practices were shared by the Chinese and U.S. representatives at the meeting.

Progress is being made toward normalizing laws and regulations governing the NGO sector, with a focus on communication, development of training and educational materials and programs to facilitate learning about not-for-profit laws and administrative and judicial systems. Many organizations around the world are conducting and supporting legal, sociological and other research needed to strengthen and improve laws and legal systems for NGOs. Ultimately, these efforts should lead to substantial simplification of U.S. laws governing international grantmaking. The legal and nonprofit communities will continue to work with and educate the IRS and the legislature as not-for-profit laws around the world adopt similar standards and regulatory

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67 The delegation included Mao Qi Xiong, Vice-Director of the Research Office Overseas Chinese Committee of the National People’s Congress of the P.R.C.; Wang Shihu, Director, State Organs Law and Administrative Law Commission, Standing Committee of the National People’s Congress; Xu Anbiao, Division Director, State Organ Law and Administrative Law Department Legislative Affairs Commission, Standing Committee of the National People’s Congress; and Yang Tuan, Vice-Chairman Research of Interchange Committee, China Charity Federation. The U.S. representatives were Dr. Frank Ellsworth of Capital Research and Management Co., Joseph Lumarda of the California Community Foundation, the author, and Michael Rea, The Asia Foundation’s Program Officer for its Asian-American Exchange.
systems, and concerns about lack of oversight of NGOs by local governments decrease. This is an era of enthusiasm and optimism in the not-for-profit sector, but much work remains to be done.

IV. The Evolving Role of Counsel

The role of counsel in working with foundations active in the international arena is not unique. Counseling such foundations, like counseling foundations whose grants are solely domestic, requires thorough knowledge of the arcane rules governing such grants as well as knowledge of current developments in this evolving field of law. We must educate the donors with whom we work; assist them in developing forms, policies and procedures appropriate to international grantmaking; and help them work through the frustrations that often accompany operating subject to a maze of technical requirements. At the end of 2000, the author worked on several equivalency determinations and grant agreements for a mid-sized foundation which funds only projects connected with the incidence of AIDS in sub-Saharan Africa, and its impact on local youth. The young founder, visionary and impassioned, was impatient with the process and applied pressure to release funds as soon as possible. Her focus was the severity and urgency of the need for assistance. As counsel, we not only have to be sure our clients observe IRS requirements, but we must also act as trusted advisors/psychologists who can reassure the foundation directors or trustees that the funds will indeed be released. Just as in the domestic arena, it can be hard to tell a client that you need more time for due diligence when the client is thinking primarily of the deaths occurring during the pre-grant compliance period and how many fatalities might be averted by prompt funding of the project. This particular foundation funds
primarily grassroots projects. As the grantees lacked sophistication and often had little experience, the process of ensuring they had the wherewithal to carry out the project, and of obtaining adequate data from them, was slower than it is when the grantee has been operating for many years and has experience with U.S. legal requirements for grants abroad. However, in Third World countries, grassroots organizations are often best positioned to deliver services due to their intimate familiarity with the culture and potential local impediments to success. Their input in refining the scope and purpose of the grants was invaluable, and counsel, the founder and the foundation’s Programs Director all knew this.

There is generally an increasing emphasis on accountability in the U.S. philanthropic sector.68 One result of this is that so-called “venture philanthropists” in particular seem comfortable with the idea of post-grant ongoing due diligence. This attitude tends, in the author’s experience, to make all of the ongoing procedural requirements for expenditure responsibility grants more palatable to them. Impatient as

these clients may be, they realize that ongoing monitoring of the project should increase the odds of its success.

It is an exciting time for counsel to international grantmakers. As overseas funding grows, many challenges face us. It is, perhaps, easiest to pinpoint how changes in U.S. laws governing such grants can be simplified while still protecting our government's interests – certainly far easier than dealing with issues such as how best to deliver services abroad and how to measure the success of overseas projects. The IRS has signaled its willingness to revise and simplify outdated and complicated rules, and much progress in the effort can be expected to occur over the next decade as grantmakers and allied professionals throughout the country join forces to facilitate this process.
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