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4945.04-05

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

Date: FEB 26 2003

Contact Person:

Identification Number:

Telephone Number:

T:EO:B1

Employer Identification Number:

Legend:

A =
B =

Dear Sir or Madam:

This is in response to a request for rulings regarding the federal income tax consequences of a grant proposed to be made by you to a foreign organization under the circumstances described below.

FACTS:

You are a nonprofit corporation recognized by the Service as a tax-exempt organization described in section 501(c)(3) of the Internal Revenue Code and a private foundation under section 509(a) of the Code. You are not an operating foundation described in section 4942(j)(3). Your charitable purposes include promoting access to quality healthcare and education.

You propose to make a grant to an organization located in A. The foreign organization is not part of the B government, or an agency or instrumentality thereof. The charitable purpose of the grant is to support the grantee in its efforts to improve the health of the in A who are suffering from . According to official statistics presented by grantee, percent of the B population is , and this percentage is expected to increase to percent by the year , with the result that A's population has one of the highest rates in the world. Grantee expects to use the grant for the following activities in furtherance of this purpose: (a)

and groups (defining the causes, types and treatments for , and providing help for patients); (b) provision of a resource to provide help to patients, utilizing volunteers to staff the line; (c) production of a manual for patients, particularly for people of and (d) presentation to medical specialists of a video about the problems that causes in the community. You have represented that neither you nor one or more disqualified persons with respect to you within the meaning of section 4942(g)(1) directly or indirectly control the foreign organization. The foreign organization has not applied for nor received recognition from the Service that it is an organization described in section 501(c)(3) or section 509(a).

You represent that you have not made a reasonable judgment or a good faith determination that the foreign organization is described in section 501(c)(3) of the Code or section 509(a)(1), (2), or (3). You have not ascertained whether or not the notice requirements of section 508(a) or (b) would apply to the foreign organization. You will not obtain records verifying that the foreign organization has distributed the full amount of your grant "out of corpus" by the end of the year following the year in which your grant is made.

You represent that you will exercise expenditure responsibility with respect to the grant to the foreign organization. You will require the foreign organization to maintain the grant funds in a separate fund dedicated to purposes described in section 170(c)(2)(B). You will (a) conduct a pre-grant inquiry concerning grantee that is complete enough to give a reasonable man assurance that the grantee will use the grant for the proper purposes; (b) require the grantee to sign a written commitment; (c) obtain full and complete reports from grantee showing how the funds are used by grantee, grantee's compliance with the terms of the grant, and progress made by grantee toward achieving the purposes for which the grant was made; and (d) make full and detailed annual reports to the IRS with respect to the grant to grantee, which will be submitted on or with your annual Form 990-PF, *Return of Private Foundation or Section 4947(a)(1) Trust Treated as a Private Foundation.* You have engaged an independent accounting firm with experience in assisting private foundations in implementing expenditure responsibility procedures to assist you in complying with your expenditure responsibility requirements with respect to the grant.

You request the following rulings:

1. That your grant to the foreign organization will be a qualifying distribution under section 4942 of the Code.

2. That your grant to the foreign organization will not be a taxable expenditure under section 4945 of the Code.

3. That these conclusions will hold true regardless of whether the notice requirements of section 508(a) or (b) apply to the foreign organization.

4. That these conclusions will hold true regardless of whether (a) you have the capacity to make a reasonable judgment or good faith determination with respect to the foreign organization, (b) you have embarked on the procedure to collect the necessary information to make such a reasonable judgment or good faith determination but did not reach a definitive conclusion, or (c) another U.S. private foundation has made a reasonable judgment or good faith determination with respect to the foreign organization.

APPLICABLE LAW:

Section 170(c)(2)(B) of the Code describes a corporation, trust, or community chest, fund, or foundation organized and operated exclusively for, among other purposes, religious, charitable, scientific, literary, or educational purposes.

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

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

Section 4942(g)(3) of the Code provides that a contribution from a private foundation to another private foundation which is not an operating foundation will be treated as a qualifying distribution if the recipient foundation makes a qualifying distribution of the same amount which is treated as a distribution "out of corpus" by the end of the first taxable year following the taxable year in which the contribution is received and the recipient foundation maintains adequate records. In general, a distribution will be treated as a distribution "out of corpus" only if the recipient foundation had made other qualifying distributions at least equal to its distributable amount. See section 53.4942(a)-3(d) of the Foundation and Similar Excise Tax regulations.

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

Section 4945(d)(4) of the Code provides that a grant to an organization other than

a section 501(c)(3) organization described in section 509(a)(1), (2), or (3) will be a taxable expenditure unless the private foundation making the grant exercises expenditure responsibility with respect to the grant.

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

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

Section 508(a) of the Code generally prohibits an organization from being treated as described in section 501(c)(3) unless it has filed notice with the Secretary of the Treasury that it is applying for recognition of such status. The Secretary prescribes the method for filing the notice.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations defines the term "charitable" in its generally accepted legal sense. Such term includes relief of the poor and distressed.

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

Section 53.4945-5(a)(5) of the regulations provides that if a private foundation makes a grant to a foreign organization that has not received a determination letter confirming that it is an organization described in section 509(a)(1), (2), or (3) of the Code, such a grant will be treated as a distribution made to an organization described in section 509(a)(1), (2), or (3) or 4942(j)(3) if the distributing foundation has made a good faith determination (as defined in the regulation) that the grantee foundation is an organization is described in section 509(a)(1), (2), or (3).

Section 53.4945-5(b)(2) of the regulations provides that before making a grant to an organization with respect to which expenditure responsibility must be exercised, a

private foundation should conduct a limited inquiry concerning the potential grantee. Such inquiry should be complete enough to give a reasonable man assurance that the grantee will use the grant for the proper purposes.

Section 53.4945-5(b)(3) of the regulations provides that a private foundation must require that each grant to an organization, with respect to which expenditure responsibility must be exercised, be made subject to a written commitment signed by an appropriate officer, director or trustee of the grantee organization, to repay any portion of the amount granted which is not used for the purposes of the grant, to submit full and complete annual reports on the manner in which the funds are spent and the progress made in accomplishing the purposes of the grant, to maintain records of receipts and expenditures and to make its books and records available to the grantor at reasonable times, and not to use the funds to carry on propaganda or to influence the outcome of any specific public election.

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

Section 53.4945-5(c)(1) of the regulations provides that the granting private foundation shall require reports on the use of the funds, compliance with the terms of the grant, and the progress made by the grantee toward achieving the purposes for which the grant was made.

Section 53.4945-5(d) of the regulations provides that to satisfy the report making requirements of this section, a granting foundation must provide the required information on its annual information return.

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

Section 53.4948-1(b) of the regulations provides that section 508 of the Code does

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

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

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

ANALYSIS:

Based on the above authorities, a grant from a private foundation to a foreign grantee will be treated as a qualifying distribution for purposes of section 4942 of the Code and not as a taxable expenditure for purposes of section 4945 under each of the following three circumstances:

1. After making a good faith determination that the foreign grantee is described in sections 501(c)(3) and 509(a) of the Code, the private foundation makes the grant without exercising expenditure responsibility;

2. After making a good faith determination that the foreign grantee is described in section 501(c)(3) of the Code and would be classified as a private foundation because it is not described in section 509(a), the private foundation exercises expenditure responsibility with respect to the grant as prescribed by section 4945(h) and the regulations thereunder, and obtains records verifying that the grantee distributes the full amount of the grant out of corpus by the end of the year following the year in which the grant is made, in accordance with section 4942(g)(3);

3. The private foundation treats the grantee as not being described in section 501(c)(3) of the Code and exercises expenditure responsibility with respect to the grant as prescribed in section 4945(h) and the regulations thereunder, including the

requirement that the grantee maintain the grant funds in a separate fund dedicated for section 170(c)(2)(B) purposes, in accordance with section 53. 4945-6(c) of the regulations.

Thus, a foreign grantee should be treated as an organization described in section 501(c)(3) or as a private foundation under section 509(a) only if (1) the foreign grantee has received a ruling or determination letter recognizing such status, or (2) the grantor private foundation has made a good faith determination of such status. Nothing in the statute or regulations requires a private foundation to make such a reasonable judgment or good faith determination.

Section 4948(b) of the Code provides that a foreign organization that has received more than 85 percent of its support (other than gross investment income) from sources outside the United States could claim section 501(c)(3) status without filing a Form 1023. Further, a foreign organization formed on or before October 9, 1969, could claim section 501(c)(3) status without filing a Form 1023. Other exceptions under section 508 could also apply. However, there is no requirement that a U.S. private foundation grantor determine whether a foreign organization is subject to these exceptions. A private foundation retains full discretion and may elect to treat a foreign grantee that has not received a determination letter from the IRS as not being described in section 501(c)(3) of the Code even if it may be possible for the private foundation to make a good faith determination to the contrary.

Accordingly, a private foundation's grant to a foreign grantee will be treated as a qualifying distribution under section 4942 of the Code and not as a taxable expenditure under section 4945 if the private foundation treats the grantee as not being described in section 501(c)(3) (and, hence, not a private foundation), exercises expenditure responsibility with respect to the grant, and requires that the grantee maintain the grant funds in a separate fund dedicated to one or more purposes described in section 170(c)(2)(B). These conclusions hold true regardless of the fact that the private foundation may have the capacity to make a reasonable judgment or good faith determination with respect to the foreign organization, or may have embarked on the procedure to collect the necessary information to make a reasonable judgment or good faith determination but did not reach a definitive conclusion. These conclusions also hold true if another private foundation has made a reasonable judgment or good faith determination with respect to the foreign organization.

In your case, you have indicated that you are making a grant to a foreign organization exclusively for purposes described in section 170(c)(2)(B). The foreign organization is not directly or indirectly controlled by you or any disqualified person with respect to you within the meaning of section 4942(g)(1). The foreign organization has not applied for nor received recognition from the Service that it is an organization

described in section 501(c)(3) or section 509(a). You will exercise expenditure responsibility with respect to the grant to the foreign organization in accordance with the requirements of section 4945(h) and the regulations thereunder. You will require the foreign organization to maintain the grant funds in a separate fund dedicated to the purposes states, purposes described in section 170(c)(2)(B), in accordance with section 53.4945-6(c) of the regulations.

CONCLUSION:

Accordingly, based on the facts and discussion above, we rule as follows:

1. That your grant to the foreign organization will be a qualifying distribution under section 4942 of the Code.

2. That your grant to the foreign organization will not be a taxable expenditure under section 4945 of the Code.

3. That these conclusions will hold true regardless of whether the notice requirements of section 508(a) or (b) apply to the foreign organization.

4. That these conclusions will hold true regardless of whether (a) you have the capacity to make a reasonable judgment or good faith determination with respect to the foreign organization, (b) you have embarked on the procedure to collect the necessary information to make such a reasonable judgment or good faith determination but did not reach a definitive conclusion, or (c) another U.S. private foundation has made a reasonable judgment or good faith determination with respect to the foreign organization.

This ruling is based on the understanding that there will be no material change in the facts upon which it is based. Any changes that may have a bearing on your tax status should be reported to the Service. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Because this letter could help resolve future questions about your federal tax responsibility, please keep a copy of this ruling in your permanent records. If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

We have sent a copy of this letter to your authorized representative as indicated in your power of attorney.

Sincerely,

(signed) Marvin Friedlander
Marvin Friedlander
Manager, Exempt Organizations
Technical Group 1