Complex International Grantmaking: A Practical Approach

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April 24, 2015
Agenda

- What do we mean by “International Grantmaking”?
  - What are the alternatives?
- Application of ER Rules Internationally
- Equivalency Affidavits
- Withholding of Tax on Payments to Foreign Persons
- OFAC Considerations
- Unique Foreign Laws Applicable to Grantmakers
International Grantmaking Defined
International Grantmaking = Direct Cross Border Disbursements
Common Alternatives to Direct Giving

- **Fiscal Sponsor**
  - Not defined in the Code
  - Common practice is to find a US public charity willing to “sponsor” a foreign organization or project

- **“Friends of” Organization**
  - Must be operated independently of the foreign organizations they support, with discretion and control over use of funds vested with US organization
  - Typically only works for project support grants
  - Only works if sponsor/“friends of” truly has requisite discretion and control over use of funds by recipient organization
  - Donor has to live with grantee’s “variance power”
Common Alternatives to Direct Giving

- General Operating or Project Support to a US grantee with foreign operations/offices
  - Watch for earmarking!
  - Watch out for foreign operations/offices that are separate legal entities!

- Grant to a foreign organization that has obtained US tax exempt status
Practical Tips for an International Grantmaking Program

- Ensure it is permitted by donor’s governing documents

- Consider different types of international grantmaking given donor’s resources, staffing model, mission, etc.
  - U.S. public charities doing work overseas
  - U.S. intermediaries
  - Foreign governments and designated multilateral organizations
  - Foreign NGOs
Implications of Direct Grantmaking

- If a private foundation, potential need to exercise expenditure responsibility (or pursue equivalency affidavit)
- May be harder to monitor/control fund use, but may be more cost effective/efficient in building local capacity and expertise
- For all donors, potential need to become knowledgeable about foreign laws applicable to grantmaking (or PRI-making)
- OFAC/anti-bribery concerns may become more relevant (though even US programs are subject to OFAC concerns)
- Depending on level of country engagement, consider whether donor is establishing a legal “presence”/nexus in country
Expenditure Responsibility
What Does ER Require?

ER requires a foundation to establish adequate procedures to:

- ensure that the grant is spent solely for the charitable purposes for which it was made;
- to obtain full and complete reports from the grantee on how the funds are actually spent; and
- to make full and detailed reports with respect to the grantee’s expenditures to the IRS on the foundation’s Form 990-PF.
ER Applies to What?


• PRIs are considered grants under ER rules.

• Contracts are not generally subject to ER.
  
  • Grants”typically do NOT include payments (including salaries, consultants’ fees and reimbursement for travel expenses) to persons for personal services in “assisting a foundation in planning, evaluating or developing projects or areas of program activity by consulting, advising or participating in conferences organized by the foundation. Treas. Reg. § 53.4945-4(a)(2).

• Rules are the same regardless of where grants are made.
ER Applies to Whom?

**NO**
- U.S. public charities
- U.S. and foreign government units (including foreign public schools)
- Executive Order organizations
- Exempt operating foundations
- Foreign organizations with a valid equivalency affidavit

**YES**
- U.S. exempt organizations that are not public charities
- Private foundations
- Private operating foundations
- For-profit companies
- New public charities (that haven’t received their determination letter yet)
- “Tipped” former public charities
- Foreign organizations without an equivalency affidavit
- Certain earmarked subgrants
How is ER Exercised?

Step 1: Pre-Grant Evaluation

Step 2: Written Grant Agreement

Step 3: Regular Reports from Grantee and Foundation; Reports to IRS

Step 4: Investigate Diversion of Funds/Problems with Grant
Step 1: Pre-Grant Evaluation (PGE)

- Must conduct **due diligence** on grantee to assess its capacity to use and report on grant funds
- The results must be documented in writing
- Holistic inquiry (e.g. key staff, management, activities, finances)
- Scope and depth is commensurate with the size and scope of the grant
- Subsequent grants may require significantly less due diligence, depending on foundation experience
Step 2: Written Grant Agreement

All ER grants must be made pursuant to a written grant agreement that:

1. Specifies the charitable purpose of the grant;
2. Requires the grantee to maintain the grant funds in a separate account or a separate fund dedicated to charitable purposes;
3. Requires the grantee to maintain records of receipts and expenditures, and make its records available to the foundation for inspection;
4. Requires the grantee to repay grant funds if not used for the purposes of the grant (even if otherwise charitable);
5. Requires the grantee to provide annual reports and a final report (on a fiscal year basis) on its use of the grant funds;
6. Prohibits use of grant funds for lobbying, political activity, regranting (with some exceptions) and non-charitable uses; and
7. Is signed by the foundation and the grantee.
Step 3: Annual Reports

• Each year that funds remain unexpended (by the grantee or its subgrantees), a foundation must receive an Annual Report from the grantee containing:
  • a detailed breakdown of how grant funds were expended during the relevant period (even short first periods like Nov – Dec 31);
  • a narrative description of the grantee’s progress in achieving the purposes of the grant during the year; and
  • a statement that the grantee has fully complied with the terms of the grant agreement.

• An Annual Report must be received for the year in which the first disbursement of grant funds is made, and for all subsequent years until the grant funds are fully expended or the grant is otherwise terminated.

• Report must be furnished within “a reasonable period of time” after the close of the annual accounting period (generally 90 days).
Step 3: Annual Reports Until Grant Funds are “Fully Expended”

This means . . . .

• “Loan funds” or “revolving credit funds” may be problematic.

• A grant cannot be closed until all funds are expended (subgrantees/contractors too).

• Consider whether to permit a grantee to make an equity investment in another organization (as the funds could potentially remain outstanding in perpetuity).

• If grantee has funds remaining at the end of the project (either grant funds or income earned on those funds), you must work with the grantee to find an alternative use for such funds that is related to the project, or the funds must be returned to the foundation at that time.
Step 3: Final Report

- At the end of the grant period, a foundation must receive a Final Report from the grantee containing:

  1. a detailed breakdown of how grant funds were expended during the entire grant period;

  2. a narrative description of the grantee’s progress in achieving the purposes of the grant during the entire grant period; and

  3. a signed signature that the grantee complied with the terms of the grant agreement.

- The Final Report must be received within a “reasonable period of time” (generally 90 days) after the close of the grantee’s annual accounting period in which all the grant funds were expended or the grant was terminated.
Step 3: Report to IRS

• A foundation must report to the IRS annually on every ER grant made, paid, or for which a report is outstanding during the year.

• Report must include:
  • Grantee name and address
  • The date, amount and purpose of the grant
  • The amounts expended by the grantee based on the most recent grantee report
  • The date of the grantee’s reports
  • Whether the grantee has diverted funds
  • Dates and results of any verification of grantee’s reports

• A foundation must also retain grant-related records for four years.
Step 4: Investigate Diversions

- If a grantee uses all or a portion of foundation grant funds for any non-charitable purpose, or for purposes inconsistent with those specified in the grant agreement, a “diversion” has occurred.

- In this situation, a foundation must take corrective measures or risk being subject to penalties.

- Specifically, a foundation must:
  1) take “all reasonable and appropriate steps either to recover the grant funds or to insure the restoration of the diverted funds and the dedication . . . of the other grant funds held by the grantee to the purposes being financed by the grant;” and
  2) withhold any further payments to the grantee (on all grants to that grantee) until it has received appropriate assurances that further diversions will not occur, and the grantee has taken precautions to prevent further diversions from occurring.
ER Grants Involving Subgrants ("Double ER")

• If the grantee intends to make subgrants (as evidenced in its proposal, budget or discussions with a Foundation), the grantee must follow ER procedures with respect to each subgrantee that is not a US public charity, or part of the US or a foreign government.

• This means the grantee must:
  1. conduct a pre-grant inquiry for each subgrantee,
  2. enter into a written grant agreement with each subgrantee containing the terms set forth above; and
  3. receive annual reports and a final report from each subgrantee and summarize the essential information contained therein in its own reports to the foundation.
  4. follow up on potential diversions/misuse of funds.

• This rule does not apply to subcontracts.
Equivalency Affidavits
Equivalency Affidavits: the ER Alternative

- Treas. Reg. § 53.4945-5(a)(5) permits a foundation to avoid expenditure responsibility if it can make a good faith determination that, in the reasonable judgment of the foundation, the recipient organization is the functional equivalent of a US public charity. See also, Treas. Reg. § 53.4945-6(c)(2)(ii).

- The determination can be based on an affidavit of the grantee or an opinion of counsel setting forth enough information about the grantee’s operations and financial support to conclude it would likely qualify as a public charity.

- How do you actually apply this?

Equivalent to . . . . . .

- A public charity, which includes:
  - an educational institution (university or school)
  - Hospital
  - a church
  - Medical research organization
  - a publicly supported organization

OR

- A foreign government entity (technically not an “equivalency affidavit”)

## ER vs. EA

**ER Grants**

<table>
<thead>
<tr>
<th>PROs</th>
<th>CONs</th>
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</thead>
<tbody>
<tr>
<td>Fairly clear rules; somewhat “easy” to apply</td>
<td>Strictly interpreted</td>
</tr>
<tr>
<td>Permit grants to wide range of orgs, if rules followed</td>
<td>No general operating support grants; limited overhead</td>
</tr>
<tr>
<td>No tipping risk issues</td>
<td>May require “double ER” on sub-grants</td>
</tr>
<tr>
<td>Less up front work for the grantee</td>
<td>Additional rules for equipment purchases</td>
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<tr>
<td></td>
<td>Additional reporting requirements</td>
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<tr>
<td></td>
<td>Required pre-grant inquiries can be costly</td>
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</tbody>
</table>

**Equivalency Affidavits**

<table>
<thead>
<tr>
<th>PROs</th>
<th>CONs</th>
</tr>
</thead>
<tbody>
<tr>
<td>If successful, organization is treated as a public charity</td>
<td>Requires significant judgment which creates audit risk</td>
</tr>
<tr>
<td>General operating support allowed</td>
<td>Must be updated regularly</td>
</tr>
<tr>
<td>Eliminates need for ER</td>
<td>Not always possible; many foreign orgs don’t have required provisions</td>
</tr>
<tr>
<td>Can be relied on by multiple donors</td>
<td>May still need to worry about tipping risks</td>
</tr>
</tbody>
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Overview of an EA Process

I. Due Diligence Research
II. Determination to Pursue EA
III. Affidavit sent to Potential Grantee
IV. Potential Grantee Completes Affidavit
V. Final Determination Made
I. Due Diligence

- Conduct initial research on the potential grantee organization, looking at public information, considering any prior experience with them, and keeping some key questions in mind.

- Based on this quick, limited review, does it look/feel/smell like it might be a public charity or government?

(or like something else?!?!)
I. Due Diligence: Key Questions for Public Charity Equivalency

1. What is the nature of the grantee’s overall activities; what is its mission and purpose? Is it charitable?

2. Is the grantee a charitable or non-profit organization in the country of its formation? What do you know about the laws governing charities in that country?

3. What does the organization’s website say about its activities? (anything inconsistent with charitable status?)

4. Does the grantee do anything that looks like a trade or business, or that benefits private interests?

5. What are the organization’s primary sources of support?
I. Due Diligence: Key Questions for Government Entity Status

1. Is the grantee clearly affiliated with a foreign government? Does the website look like its part of the government’s site? Does the organization’s name indicate it is part of the government?

2. Does a foreign government own the potential grantee?

3. Is the grantee substantially funded by the foreign government?

4. Was the potential grantee created by statute, regulation or other exercise of governmental authority?
I. Due Diligence: Government Entities

- Does the Grantee have one or more **sovereign powers** (power to tax, power of eminent domain, or police power)?
  - See Rev. Rul. 77-165, 1977-1 C.B. 21

- Is the entity an **“instrumentality”** of a foreign government? See Rev. Ru. 57-128, 1957-1 C.B. 311
  - Is the organization used for a governmental purpose and performs a governmental function;
  - Is the performance of the organization’s functions on behalf of one or more states or political subdivisions;
  - Are private interests involved, or do the states or political subdivisions involved have the powers and interests of an owner;
  - Is control or supervision of the organization vested in public authority or authorities;
  - Is express or implied statutory or other authority necessary or does it exist for the creation and/or use of the organization; and
  - What is the organization’s degree of financial autonomy and the source of its operating expenses.
II. Decision to Pursue EA

• Based on available information, and capacity of foundation staff to process, and grantee staff to provide, required information.

• Consider using external resources such as NGO Source, outside counsel, etc.
III. Send Materials to Grantee

- Develop a consistent template to be used, with instructions.
- Consider a separate template for governments.
- If you commonly work in certain countries, consider translating affidavit and instructions to ensure clarity of questions (though response/affidavit must be in English).
- If the organization is new, a different schedule of financial support may be required. Common practice is to use Schedule A of Form 990.
IV. Review Materials

- Ensure materials are complete and in English.

- Areas to check before (most mistakes are here):
  - Missing supporting documents
  - Governing documents do not contain the provisions required under US law
  - Incorrectly completed support schedule
  - Documents not in English or very poor translations

- Possible back-and-forth with prospective grantee for clarification or, in limited cases, to seek modifications to their organizing documents.
V. Make Determination; Inform Grantee

- Consider preparing a memo for foundation records summarizing conclusions about why the organization is a public charity equivalent.
- Save all documentation and affidavits in foundation records.
- Remember to ensure affidavit stays current – affidavit must be updated from time to time. See Rev. Proc. 92-94.
Withholding Requirements
Tax Withholding

- Sections 1441, 1442, and 1443 of the Code
- Required when withholding agent makes
  - payment of
  - U.S.-source FDAP and similar income
  - to a foreign person
- Usually 30% of gross amount, but may be reduced by statute or treaty
Tax Withholding by Grantmakers

- May be required if grant funds used for U.S. activities or travel
## Documentation Required for Exceptions

<table>
<thead>
<tr>
<th>Grant recipient</th>
<th>IRS form</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign government</td>
<td>W-8EXP</td>
</tr>
<tr>
<td>(investment income only)</td>
<td></td>
</tr>
<tr>
<td>International organization</td>
<td>W-8EXP</td>
</tr>
<tr>
<td>Charity</td>
<td>W-8EXP</td>
</tr>
<tr>
<td>(IRS determination letter or equivalency determination)</td>
<td></td>
</tr>
<tr>
<td>Subject to treaty-based exception</td>
<td>W-8BEN/W-8BEN-E/Form 8233</td>
</tr>
</tbody>
</table>
Tax Withholding Applied to Grants

- Do grants qualify as U.S.-source income?
  - Targeted grants
  - Grants as gifts
Tax Withholding and Grants as Gifts

Rev. Rul. 99-44
Individual, fed funded demo

Rev. Rul. 2003-12
Katrina

EO Instr. FY 2003
Post-9/11 businesses

PLR 200529004

Rev. Rul. 2006-27
Low-income home buyers
Satisfying the Withholding Requirement

- Calculate withholding amount
- Segregate withheld taxes
- Report to IRS and recipients using Form 1042/1042-S

If done properly, grantee does not need to file a U.S. tax return.
Practical Tips for Tax Withholding

✓ Coordinate staff who process grants and staff who process IRS payments and reports
✓ Obtain necessary documentation
Anti-Bribery and OFAC Rules
Executive Order 13224 and Global Terrorism Sanctions Regulations

- **Intent:** disrupt financial support of terrorists
- **Means:**
  - Block assets, regardless of intent or knowledge, without any prior notice
  - Civil and criminal penalties
  - Loss of exemption
USA PATRIOT Act

- **Intent:** provide tools to investigate and combat terrorism
- **Means:**
  - Criminal and civil penalties for knowingly or intentionally providing material support to terrorists
  - Loss of exemption
  - Considerably expanded surveillance abilities
Office of Foreign Asset Control (OFAC)

- Cannot use funds to support terrorism, narcotics trafficking, money laundering, and similar activities
  - No financial transactions with Specially Designated Nationals (SDN)
  - Country sanctions
Checking OFAC and Other Lists

- Lists kept by OFAC, EU, UN, and others
  - If payee on the list, cannot make payment
  - Prohibition extends to subgrantees and subcontractors, as well as reimbursements and other payments
Practical Tips for Compliance with Anti-Terrorism Rules

✔ Consider guidance and develop appropriate policy
✔ Conduct training
✔ Check lists (upon consideration and prior to payment)
✔ Include special language in grant agreements
✔ Maintain accurate documentation
✔ Grantee audits or site visits?
Country Sanctions Program

- Country can be sanctioned for many reasons:
  - High risk of terrorist or other prohibited activity
  - Foreign policy or security interests of the U.S. government are threatened
## Country Sanctions

<table>
<thead>
<tr>
<th>Type</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Comprehensive</td>
<td>prohibits virtually all activity by US persons in the country, or with residents of that country</td>
</tr>
<tr>
<td>Limited</td>
<td>prohibits transactions with persons on the SDN list</td>
</tr>
<tr>
<td>Targeted</td>
<td>prohibits certain categories of activities/transactions in the country and with the country’s government, as well as with persons identified on the SDN List</td>
</tr>
</tbody>
</table>
Country Sanctions Program

- Countries subject to sanctions:
  Afghanistan, Balkans, Belarus, Burma/Myanmar, Cote D’Ivoire, DRC, Gaza/West Bank, Iraq, Lebanon, Liberia, Libya, North Korea, Russia, Somalia, Sudan, Syria, Ukraine, Yemen, and Zimbabwe

Changing times: Cuba and Iran
Practical Tips for Country Sanctions

- Get help
- Stay current
- Develop system to ensure grants, contracts, and expense reimbursements considered
- Consider applying for OFAC license
Anti-bribery Rules

- Foreign Corrupt Practices Act (FCPA) and anti-bribery laws (UK Anti-bribery Act)

Practical tips
- Include anti-bribery provisions in grant agreements and vendor contracts
- Conduct targeted training
Unique Foreign Rules Applicable to Grantmaking
Country-Specific Considerations

- Bangladesh
- China
- Egypt
- Ethiopia
- India
- Mexico
- Nigeria
- Vietnam
Bangladesh

- Foreign Donations (Voluntary Activities) Regulation Rules, 1978 requires pre-approval to accept grants from foreign sources
- New (pending) legislation adds reporting requirements and penalties
China

- Nonprofits must obtain government approval to establish a legal entity, work in China or to transfer funds into the country.
- Notice of the State Administration of Foreign Exchange on Issues concerning the Administration of Foreign Exchange Donated to or by Domestic Institutions, 2009
  - Difficult for foreign organizations to obtain permission to donate funds.
Ethiopia

- Proclamation to Provide for the Registration and Regulation of Charities and Societies, 2009
  - Requires registration and reporting
  - Prohibits certain activities based on receipt of foreign funding
  - Foreign organizations seeking to work in Ethiopia need pre-approval
India

- **Foreign Contribution Regulation Act, 2010 (FCRA)**
  - Requires approval before receiving foreign contributions
  - Prohibits subgrants outside India
  - Prohibits grants to media companies

**Practical tips**
- ✓ Verify status and obtain copy of FCRA registration
- ✓ Monitor status throughout grant term
Mexico

- **Ley Federal para la Prevención e Identificación de Operaciones con Recursos de Procedencia Ilícita, 2013 (LFPIORPI)**
  - Defines donations as “vulnerable activities”
  - Requires registration and reporting, including information about donors

**Practical tips**

✓ Create checklist of documents to provide upon request
Vietnam

- **Decree No. 93-2009 – ND-CP**
  - Regulates management and use of foreign contributions from international NGOs
    - “Priority areas” for foreign aid
    - Prior approval required for foreign contributions
Thank you!

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