



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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Contact Person:

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Legend:

M =

Dear :

We have considered your ruling request dated January 29, 2004 and modified by your letter of October 19, 2004, in which you requested certain rulings under section 4945 of the Internal Revenue Code ("Code") and section 53.4945-5 of the Foundation and Similar Excise Taxes Regulations ("Regulations"). You have requested the following ruling:

If M exercises expenditure responsibility in a manner that would satisfy the requirements of section 53.4945-5 of the regulations, if such requirements applied to M and that M reporting shall fulfill the requirements of that section whether the grant funds originate with M or a U.S. foundation donor.

M is an independent agency of the United States government, established pursuant to the Foreign Assistance Act of 1969. M is a government corporation under 5 USC 552 and its employees are federal employees, subject to the regulations of the Civil Service Commission. M's activities are subject to review and oversight by the Inspector General, Foreign Assistance.

In a letter dated April 11, 1973, the Service ruled that M is an integral part of the United States, it is a governmental unit described in section 170(b)(1)(A)(v), and contributions to M are deductible under section 170 of the Code. M states that there have been no material changes in the facts upon which the 1973 ruling was based.

The purpose of M is to provide grants to grassroots and community based organizations in Latin America and the Caribbean to help those countries implement their own creative ideas for development and poverty reduction. M's grant program provides funds for enterprise development including food production and agriculture, education, training and ecocodevelopment.

M procedures require a pre-grant inquiry on all potential grantees. A foundation representative meets with each potential grantee organization to assess the merits of the proposal and the capacity of the organization to carry out the proposed activities. The foundation representative also meets with intended beneficiaries, consults with USAID and U.S. Embassy officials and conducts a broad inquiry regarding the applicant organization.

M procedures require that all grants be made pursuant to the *Standard Grant Agreement*, which must be signed by an officer, director or trustee of the grantee. The *Standard Grant Agreement* includes the grant letter, Grantee's proposal and modifications, if applicable, "Terms and Conditions of the Grant," Budget, "Disbursement Request," "Financial Report," "Program Activity and Results Report," and "Grantee Certification of Drug-Free Workplace Requirements. The *Standard Grant Agreement* sets out the amount and use of the grant in accordance with the activities and budget. Grantees must open a separate bank account to use for the funds, and there must be a financial tracking of the funds and expenditures related to the grant. Grantees are required to return any unused grant funds upon expiration of the agreement. Financial reports are provided every 6 months. Grantees must agree to audits by a firm selected by M and M reserves the right to suspend disbursements.

M has policies and procedures that prohibit grantees from using any of the grant funds or income therefrom for lobbying or political activities. In the case of earmarked private foundation grants for which expenditure responsibility is required, M will annually provide the required information to the grantor for each such grant made by M during the taxable year. M will provide the name and address of the grantee, date and amount of the grant, purpose, amounts expended, whether there has been any diversion of the funds, and verification of the grantee reports.

While M has not historically made program-related investments, M indicates that upon entering into such transactions, M procedures will provide that any program-related investment must be made subject to a written commitment signed by an appropriate officer, director or trustee of the recipient organization. The written commitment will specify the purpose of the investment and include an agreement by the recipient organization to use the funds only for that purpose and to repay any portion not used for such purposes, and at least once a year during the existence of the program-related investment, submit a full and complete financial report and a statement that it has complied with the terms of the investment, maintain adequate books and records, and not use any of the funds to carry on propaganda or otherwise influence legislation.

As noted above, M requires all grantees to provide financial reports and program activity and results reports to M every six months during the period of the grant. A final report is due within 30 days of the termination or expiration of the grant.

In cases where funds have been diverted, M will take all reasonable and appropriate steps to either recover the grant funds or to insure the restoration of the diverted funds and the dedication of other grant funds held by the grantee. In addition, M will withhold further funds.

Section 4945(a) and (b) of the Code imposes an excise tax on each "taxable expenditure," defined in section 4945(d), of a private foundation.

Section 4945(d)(4) of the Code defines “taxable expenditures” to include any amount paid or incurred by a private foundation as a grant to an organization, unless (A) the grantee is described in paragraph (1), (2), or (3) of section 509(a) of the Code, or is an exempt operating foundation (as defined in section 4940(d)(2)(B)); or (B) the foundation exercises “expenditure responsibility” over the grant, in accordance with section 4945(h).

Section 4945(d)(5) of the Code defines “taxable expenditures” to include any amount a private foundation pays or incurs for any purpose other than one specified in section 170(c)(2)(B).

Section 4945(h) of the Code, a private foundation will be considered to exercise expenditure responsibility if it exerts all reasonable efforts and establishes adequate procedures to see that the grant is spent solely for the purpose for which it was made, to obtain full and complete reports from the grantee on how the funds are spent, and to make full and detailed reports with respect to such expenditures to the Commissioner.

Section 53.4945-5(a)(1) of the Foundation and Similar Excise Taxes Regulations provides that the term “taxable expenditure” includes any amount paid or incurred by a private foundation as a grant to an organization (other than an organization described in section 509(a)(1), (2), or (3)), unless the private foundation exercises expenditure responsibility with respect to such grant in accordance with section 4945(h) of the Code.

Section 53.4945-5(a)(4)(ii) of the Foundation and Similar Excise Taxes Regulations provides that for purposes of section 4945(d)(4) of the Code, an organization will be treated as a section 509(a)(1) organization if it is an organization described in section 170(c)(1). However, a grant to such an organization must be made exclusively for charitable purposes described in section 170(c)(2)(B).

Section 53.4945-5(a)(6) of the regulations provides that a grant by a private foundation to a grantee organization which the grantee organization uses to make payments to another organization shall not be regarded as a grant by the private foundation to the secondary grantee if the foundation does not earmark the use of the grant for any named secondary grantee and there does not exist an agreement to cause the selection of the secondary grantee.

Section 53.4945-5(b)(1) of the regulations provides that a private foundation will be considered to be exercising “expenditure responsibility” under section 4945(h) as long as it exerts all reasonable efforts and establishes adequate procedures to see that the grant is spent solely for the purpose for which made, to obtain full and complete reports from the grantee on how the funds are spent, and to obtain full and detailed reports with respect to such expenditures to the Commissioner.

Section 53.4945-5(b)(2) of the regulations requires that the private foundation conduct a pre-grant, 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. The inquiry should concern itself with matters such as: (a) The identity, prior history and experience (if any) of the grantee organization and its managers; and (b) any knowledge which the

private foundation has (based on prior experience or otherwise) of, or other information which is readily available concerning, the management, activities, and practices of the grantee organization.

Section 53.4945-5(b)(3) of the regulations provides that in order to meet the expenditure responsibility requirements of section 4945(h), a private foundation must require that each grant to an organization, with respect to which expenditure responsibility must be exercised under this section, be made subject to a written commitment signed by an appropriate officer, director, or trustee of the grantee organization. Such commitment must include an agreement by the grantee:

- (i) To repay any portion of the amount granted which is not used for the purposes of the grant,
- (ii) 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, except as provided in paragraph (c)(2) of this section,
- (iii) To maintain records of receipts and expenditures and to make its books and records available to the grantor at reasonable times, and
- (iv) Not to use any of the funds—(a) To carry on propaganda, or otherwise to attempt, to influence legislation (within the meaning of section 4945(d)(1)); (b) To influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive (within the meaning of section 4945(d)(2)); (c) To make any grant which does not comply with the requirements of section 4945(d)(3) or (4), or (d) To undertake any activity for any purpose other than one specified in section 170(c)(2)(B).

The agreement must also clearly specify the purposes of the grant. Such purposes may include contributing for capital endowment, for the purchase of capital equipment, or for general support provided that neither the grants nor the income therefrom may be used for purposes other than those described in section 170(c)(2)(B).

Section 53.4945-5(b)(4) of the regulations provides that in the case of program-related investments, a private foundation must require that each such investment with respect to which expenditure responsibility must be exercised under section 4945(d)(4) and (h) and this section be made subject to a written commitment signed by an appropriate officer, director, or trustee of the recipient organization. Such commitment must specify the purpose of the investment and must include an agreement by the organization:

- (i) To use all the funds received from the private foundation (as determined under paragraph (c)(3) of this section) only for the purposes of the investment and to repay any portion not used for such purposes, provided that, with respect to equity investments, such repayment shall be made only to the extent permitted by applicable law concerning distributions to holders of equity interests,
- (ii) At least once a year during the existence of the program-related investment, to submit full and complete financial reports of the type ordinarily required by commercial investors under similar circumstances and a statement that it has complied with the terms of the investment,
- (iii) To maintain books and records adequate to provide information ordinarily required by commercial investors under similar circumstances and to make such books and

- records available to the private foundation at reasonable times, and
- (iv) Not to use any of the funds –(a) To carry on propaganda, or otherwise to attempt, to influence legislation (within the meaning of section 4945(d)(1)); (b) To influence the outcome of any specific public election, or to carry on directly or indirectly, and voter registration drive (within the meaning of section 4945(d)(2)), or (c) With respect to any recipient which is a private foundation (as defined in section 509(a)), to make any grant which does not comply with the requirements of section 4945 (d)(3) or (4).

Section 53.4945-5(b)(5) of the regulations provides that in certain grants to foreign organizations (other than an organization described in section 509(a)(1), (2), or (3) or treated as so described pursuant to paragraph (a)(4) or (a)(5) of this section), subparagraph (3)(iv) or (4)(iv) of this paragraph shall be deemed satisfied if the agreement referred to in subparagraph (3) or (4) of this paragraph imposes restrictions on the use of the grant substantially equivalent to the limitations imposed on a domestic private foundation under section 4945(d).

Accordingly, based on the facts represented that M's grant making program is in furtherance of a purpose described in section 170(c)(2)(B) of the Code, we rule that M exercises expenditure responsibility in a manner that would satisfy the requirements of section 53.4945-5 of the regulations, if such requirements applied to M and that M reporting shall fulfill the requirements of that section whether the grant funds originate with M or a domestic (United States) foundation donor.

Because this ruling letter could help resolve any questions, please keep it in M's permanent records.

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

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.

Sincerely,

Jane Baniewicz
Manager, Exempt Organizations
Technical Group 2