



Via Overnight Delivery

March 22, 2010

Emily Lam, Esq.
Attorney Advisor, Office of Tax Policy
U.S. Department of Treasury
1500 Pennsylvania Avenue, NW
Room 1313-A MT
Washington, DC 20220

Re: Equivalency Determination Information Repositories

Dear Emily:

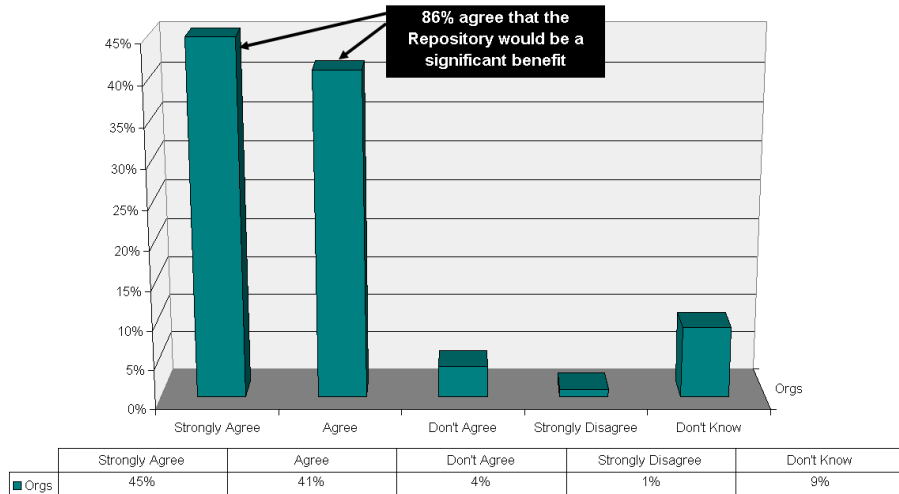
I am writing to follow up on our meeting on February 19 regarding the possibility of issuing guidance to allow private foundations to rely on information and equivalency certificates provided by a centralized equivalency determination information repository (“EDIR”). We were encouraged by your interest in the proposal, and understand the need to make sure that if Treasury authorizes such repositories, it does so in a way calculated to take advantage of their considerable ability to improve the quality of equivalency determinations and help guard against diversions of charitable resources, without opening any doors to abuse. To that end, this letter provides additional information that we hope will be responsive to the concerns expressed at the meeting.

I. Interest in the Repository Specifically and EDIRs more generally

You asked at our meeting about how many grantmakers might use an EDIR if approved—and specifically about how many might use the NGOsource repository currently in the final stages of development (the “Repository”). In the course of studying the feasibility of the Repository, the consortium backing its development has done extensive research on this very question. In brief, our best data confirms that there is a strong interest in the idea of an EDIR in the grantmaking community. According to a

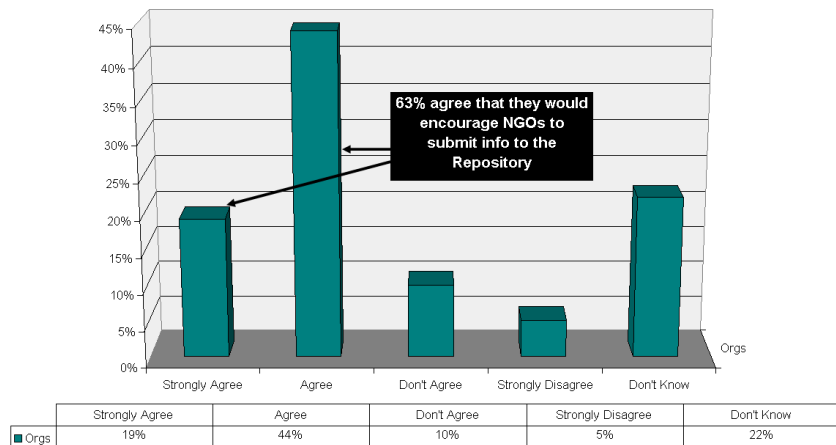
2006 feasibility survey, of some 79 U.S. grantmakers, almost all respondents believed that the a centralized repository of vetted NGO information would benefit U.S. philanthropy¹:

Q31a. The availability of a centralized repository of vetted non-U.S. based NGO information would be a significant benefit to U.S. philanthropy



A strong majority would have their grantees submit their information to a centralized EDIR along the lines of the Repository²:

Q31e. We would encourage all non-U.S. based NGOs seeking grants from us to submit their information to the central repository



¹ Information Age Associates, *Potential of Creating a Centralized Repository of Information on Non-U.S. Based NGOs: Findings and Recommendations*, at 24 (Dec. 2006).

² *Id.*

Of course, many grantmakers are understandably awaiting guidance from the IRS or Treasury confirming that they may permissibly rely on information or analysis provided by a third-party repository; some 77% regard such confirmation as an important factor in determining whether they would use such a repository.³ Still, according to a 2009 survey, over 40% of the 98 respondents surveyed (primarily private foundations, but also including community foundations and other U.S. grantmakers) indicated that they would rely on the Repository for all or almost all of their equivalency determinations, with most others neutral or undecided.⁴ We expect that the percentage of grantmakers planning to use the Repository will further increase if Treasury formally approves a workable process for establishing EDIRs.

The available survey data also confirms that the current equivalency determination process is burdensome and costly. As we noted in our previous correspondence, some 56 grantmakers surveyed in 2006 spent an estimated \$2.9 million in equivalency determination costs.⁵ A major reason for these costs is the difficulty in explaining U.S. legal concepts to foreign charities, sometimes in the face of considerable language, cultural, and logistical barriers. More than half of surveyed foreign grantees indicated that they had difficulty understanding or complying with U.S. grantmakers' attempts to obtain information about their public charity status⁶:

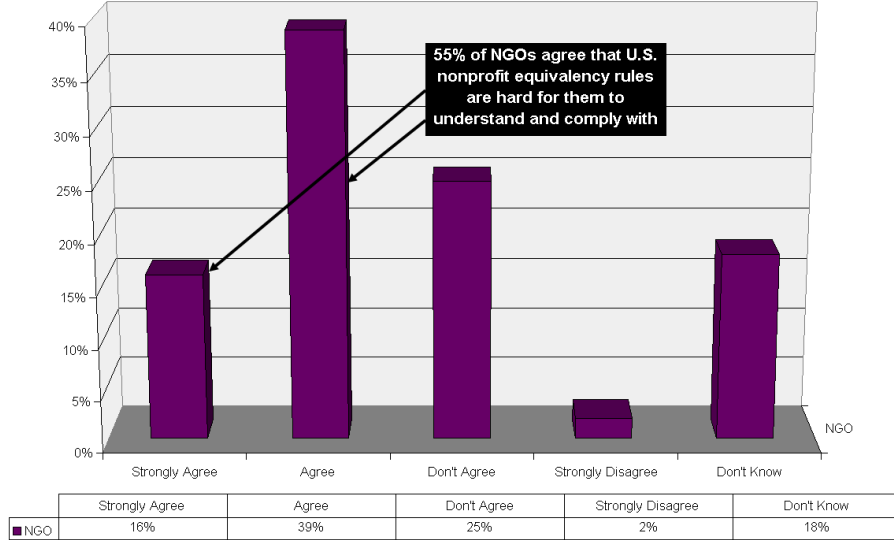
³ *Id.* at 25.

⁴ See TechSoup Global/Council on Foundations *Equivalency Determination Information Repository (EDIR) International Grantmaker Survey: May 2009 Results Highlights*, at 6.

⁵ Information Age Associates, *supra* note 1, at 24.

⁶ *Id.* at 33.

Q11a. U.S. government regulations about nonprofit equivalency are hard for us to understand and comply with



As a result of this core difficulty, grantees frequently provide the wrong information in response to grantmakers’ queries, resulting at best in a time-consuming attempt to obtain clarification. Moreover, grantee misunderstandings increase the risk that they will provide inaccurate responses on an equivalency affidavit. A major advantage of the planned Repository will be its extensive network of local partners to help overcome these barriers to understanding and increase both the ease of obtaining information from grantees and the accuracy of the information obtained. Furthermore, it is worth noting that foreign grantees are not the only ones who sometimes lack a sophisticated understanding of U.S. tax concepts. The Repository’s experience to date indicates that its planned protocols for gathering and analyzing equivalency information about prospective grantees will be considerably more extensive than those of many grantmakers, particularly smaller grantmakers. We expect that the IRS could set its standards for approving EDIRs sufficiently high that this would be the case for other approved EDIRs as well.

If you desire more information, we would encourage you to review online the reports from which the foregoing statistics are drawn.⁷ Of course, survey data cannot fully capture the enthusiasm that many grantmakers and grantees alike have expressed for a centralized repository of equivalency information. Perhaps the strongest demonstration of support for the Repository is the more than \$2.8 million in grant funds U.S. grantmakers have provided to help make the Repository a reality. We are confident

⁷ See <http://www.iaa.com/resources/NGOFeasibilityStudyFindingsandRecommendations-Dec2006.pdf>; <http://www.iaa.com/resources/EDIRSurvey2009.pdf>.

that, with the help of appropriately enabling guidance from the Treasury Department, the Repository would have the critical mass of participants it needs to provide a lasting benefit to the U.S. philanthropic community.

II. Charitable Nature of the Repository

In our meeting, you asked us a number of questions about the business model for EDIRs and specifically for the currently planned Repository. While of course business models may differ from EDIR to EDIR, our research and analysis makes us comfortable that an EDIR can be operated in a way that is consistent with section 501(c)(3) exempt status and that does not constitute unrelated business activity. We discuss the specific plans of the Repository below as a useful illustration of how EDIR operations can be conducted in a charitable manner, although we also believe that not every possible way of operating an EDIR would be charitable.

Virtually all of the initial funding for the planning and development of the Repository has come in the form of grant funding (as noted above, over \$2.8 million to date), which has allowed the Repository to develop the sophisticated data collection systems, international partner networks, and other start-up capital that the Repository will need to function. Although the Repository plans to charge fees in order to sustain its operations, it is still expected that those fees will be a fraction of what external legal counsel might charge (which can be as much as \$5,000 or \$10,000 for a single equivalency determination):

Currently projected fees for grantmaking foundations using the Repository

	Subscription Level				
	1	2	3	4	5
Number of ED Requests per year	1 to 9	10 to 29	30 to 59	60 to 99	100+
Annual Membership Fee	\$1,000	\$1,900	\$4,600	\$10,000	\$14,500
ED Processing Fee (for NGOs new to NGOsource)	\$1,445 to 1,760 (varies by volume)				
ED Update Fee (for NGOs with some data in NGOsource, but this data needs to be updated and reviewed)	\$800				
Current ED (for NGOs that have an up-to-date certified status that is still valid)	\$250				

It is worth stressing that these are only provisional fees, and the Repository may vary these terms in accordance with the needs of particular grantmakers or as it adjusts its expected costs and number of users in light of ongoing experience. Even at these

rates, it is expected that the Repository will not be self-sufficient until approximately February 2014. Of course, as the Repository grows, the cost per equivalency should go down, as information about more and more foreign charities will already exist in the Repository. In addition, as the number of EDs requested per foreign charity goes up, the Repository may be able to lower its fees per request further and still remain self-sustaining.

Authorities demonstrating that the Repository's activities further charitable purposes

This model of operations is well within the permissible bounds of what a section 501(c)(3) organization may conduct. It is well-established that an organization may further charitable purposes by providing a resource that supports or increases the efficiency of charitable work conducted by other organizations. For instance, an organization that maintained and improved a library classification system for use by libraries and similar educational institutions was held to be charitable, even though it did not directly provide educational resources to the public.⁸ Similarly, in Revenue Ruling 74-146,⁹ the Service noted that an organization furthered charitable purposes by accrediting schools and universities in a particular geographic region. According to the Service, “[t]he development and publication of standards for accreditation of schools and colleges, along with their regular inspection and evaluation . . . support and advance education by providing significant incentive for maintaining a high quality educational program.”¹⁰ It bears noting that this organization received no contributed support, but rather derived all of its revenue in the form of dues from member organizations. Further, it provided no financial assistance to other charities. Thus, its charitable status rested solely on the fact that its accreditation program identified and encouraged schools meeting the applicable charitable standards.

Similarly, in two revenue rulings highly relevant to the Repository at issue here, the Service held that 501(c)(3) organizations may serve their charitable purposes by providing other organizations (universities and libraries) technological tools for sharing or exchanging information more efficiently. First, in Revenue Ruling 74-614, the Service upheld the section 501(c)(3) status of an organization that provided a computer network for universities and other educational institutions to share information and computing resources. Then, in Revenue Ruling 81-29, the Service ruled that an organization was described in section 501(c)(3) when its sole activity was to operate a computer network to share bibliographic information among libraries (including some non-charitable

⁸ *Forest Press v. Comm’r*, 22 T.C. 265 (1954).

⁹ Rev. Rul. 74-146, 1974-1 C.B. 129.

¹⁰ *Id.*

libraries). In both instances, the common network was used to share information directly relevant to the charitable purposes of the participating institutions, not simply to carry out generic processing functions such as financial billing. Also, in both cases the organization financed its operations by charging fees for participating institutions' use of its resources and services.¹¹

As these rulings indicate, the fact that an organization charges reasonable fees in order to preserve its ability to offer its charitable resource on a sustainable basis is not normally a bar to section 501(c)(3) status. In the Service's most extended consideration of the charging of fees, General Counsel Memorandum 37257, Chief Counsel concluded that "in the vast majority of section 501(c)(3) cases the fact that an organization charges for goods or services is irrelevant."¹² As that General Counsel Memorandum notes, many traditional and nontraditional organizations providing facilities that serve charitable purposes have been approved under section 501(c)(3) even though they charge fees sufficient to make them self-sustaining.¹³

Fees are only a bar to charitable status if, in their specific context, they negate the organization's charitable purpose or indicate a substantial nonexempt purpose. For instance, General Counsel Memorandum 37257 notes that an organization providing goods to the poor ostensibly to relieve poverty would not qualify as charitable if in fact it charged the poor market rates, as no poverty would thereby be relieved. Similarly, an organization whose sole activity consists in providing ordinary commercial services at market rates or at cost cannot qualify for exemption merely by restricting its services to charitable clients. In such circumstances, the organization's purpose of conducting an ordinary commercial business has been viewed as more than incidental to any charitable purposes of the activity. In one frequently cited case, *BSW Group v. Commissioner*,¹⁴ the Tax Court applied this rationale to determine that a company providing the services of consultants to charities at a small profit was not exempt. In that case, there was no evidence that the work of the consultants directly accomplished charitable purposes; the

¹¹ Rev. Rul. 81-29, 1981-1 C.B. 329; Rev. Rul. 74-614, 1974-2 C.B. 164.

¹² G.C.M. 37257 (May 5, 1978).

¹³ See, e.g., Rev. Rul. 69-545, 1969-2 C.B. 117 (hospital is of significant benefit to the community even though it charges for its services and actually derives a net profit from operations); Rev. Rul. 72-124, 1972-1 C.B. 145 (old age home may qualify for section 501(c)(3) exemption even though its entrance fees and monthly charges make it "self-supporting"); Rev. Rul. 73-434, 1973-2 C.B. 71 (education institution is described in section 501(c)(3) even though it was funded in part by charging tuition); Rev. Rul. 65-270, 1965-2 C.B. 160 (same). Many other rulings have at least noted the fact that an organization made some charge for goods or services. For example, in Rev. Rul. 76-244, 1976-1 C.B. 155, an organization that delivered meals to the homes of the aged and handicapped charged those who were able to pay a fee approximating the cost of the meals.

¹⁴ 70 T.C. 352 (1978).

court said that such evidence would have made it “sympathetic” to the organization.¹⁵ Similarly, the Service has ruled that renting property or providing management and consulting services at market rates or at cost does not qualify as charitable simply because the property or services are provided to charities.¹⁶ Rather, there must be some additional element that demonstrates how the activity in question advances charitable purposes. That element is present when the services in question are provided at substantially below cost, in effect providing a direct subsidy to the recipient charities.¹⁷ However, General Counsel Memorandum 37257 is careful to indicate that while providing such subsidies is a *sufficient* condition for 501(c)(3) status, it is not a *necessary* condition of such status unless “an organization’s claim to exempt status rests *solely* on the fact that it provides commercially available goods or services to . . . other section 501(c)(3) organizations at a reduced price” (emphasis added).

Even in the absence of such a subsidy, the Service has recognized that transactions similar to ordinary commercial transactions can be charitable when the charity’s engagement in such transactions is calculated to increase the efficiency of charitable operations. For instance, in Revenue Ruling 69-463,¹⁸ the Service held that it was a substantially related activity for a hospital to rent adjacent office space and provide administrative services to private physicians in return for a percentage of the physicians’ billings. Although providing office space and services to private businesses would ordinarily be considered unrelated to the accomplishment of exempt purposes, the Service held that they contributed importantly to the hospital’s exempt purposes by making these medical specialists more readily available for inpatient and outpatient care, thus “permitting more efficient use of existing facilities” and “making more effective use of scarce health manpower.”¹⁹ Similarly, in Revenue Ruling 69-572,²⁰ an organization used contributions to construct a building that it then rented out to member agencies of a community chest at rates sufficient to make its operations self-sustaining. The Service found the organization to be exempt because the rates charged were significantly lower than commercial rates and because locating the agencies “at one convenient central place enable[d] such agencies to make frequent use of volunteer labor on an efficient basis and

¹⁵ *Id.* at 359.

¹⁶ Rev. Rul. 72-369, 1972-2 C.B. 245 (organization providing management and consulting services not exempt); Rev. Rul. 58-547, 1958-2 C.B. 275 (rental of property from one 501(c)(3) organization to another not substantially related to charitable purposes).

¹⁷ Rev. Rul. 71-529, 1971-2 C.B. 234.

¹⁸ 1969-2 C.B. 131.

¹⁹ *Id.*

²⁰ 1969-2 C.B. 119.

promote[d] their common interests by facilitating the effective coordination of their interrelated operations and services.”²¹

In two private letter rulings recently released to different community foundations, the Service applied similar principles in the grantmaking context.²² In both cases, the foundations, in addition to administering the grantmaking programs of their own component funds, also offered a variety of services to support the grantmaking of other charities in their communities. These included such services as “undertaking research of potential grantees, designing and operating strategic grant making and scholarship programs, exercising proper oversight over the grants made, and numerous routine administrative, accounting and clerical tasks necessary for the daily operation” of a grantmaking organization.²³ The Service held that performing routine administrative, accounting, and clerical tasks for fair market fees would constitute an unrelated trade or business. However, it reached the opposite conclusion with respect to the community foundations’ grant-related services such as informing local grantmakers of effective charitable programs in need of funding, performing pre-grant inquiries to obtain the information necessary to evaluate funding, and reviewing grantee reports. The Service recognized that these services relied on the community foundations’ significant and unique expertise in philanthropy and grantmaking in their respective regions, and that providing such services substantially furthered charitable purposes because it promoted “efficient charitable giving in the local community,” “helped direct charitable giving in the local community more efficiently,” and enabled the community foundations to better coordinate their own and others’ grantmaking.²⁴ While the Service acknowledged that many commercial consultants provide similar assistance with foundation management, significant efficiencies were created by having a single, experienced charitable organization filling this role and thus providing a centralized source of information on charitable needs and opportunities in its community. As the quotations from the rulings demonstrate, the Service ruled that the creation of such efficiencies contributed importantly to the community foundations’ exempt purposes.

By operating in the manner described above, the Repository will be operating exclusively for charitable purposes by accurately identifying organizations around the world that U.S. grantmakers can treat as meeting U.S. section 501(c)(3), public charity, or

²¹ *Id.*

²² Priv. Ltr. Rul. 200832027 (May 15, 2008); Priv. Ltr. Rul. 200832028 (May 15, 2008). Private letter rulings are not binding precedent and are cited only for illustrative purposes. See I.R.C. § 6110(k)(3).

²³ Priv. Ltr. Rul. 200832027; see also Priv. Ltr. Rul. 200832028 (services included pre-grant inquiries, evaluation of proposals, designing grant programs, printing checks, and handling day-to-day inquiries).

²⁴ *Id.*

private operating foundation standards. In this way it is like the accreditation organization approved in Revenue Ruling 74-146, which advanced education by identifying organizations that maintained appropriate educational standards. By serving this function, the Repository will encourage and facilitate support for those organizations that meet the relevant IRS standards.

Relatedly, the Repository furthers charitable purposes by providing a new centralized resource that will increase the efficiency and accuracy of the equivalency determination process, and thus of foreign charitable grantmaking in general. In this way it is providing a technological resource and service that facilitates more effective accomplishment of U.S. grantmakers' work, just as the computer networks in Revenue Rulings 74-614 and 81-29 helped libraries and universities share information more efficiently, and just as a providing a centralized location for charitable activity increased efficiency in Revenue Rulings 69-463 and 69-572.

The development of a resource that provides clear, accurate information about foreign organizations' 501(c)(3) status and private foundation classification, as well as other information about their structure, activities, and finances, will constitute a clear public benefit that will help the grantmaking community direct its charitable support overseas more efficiently. As the Service recognized in the recent community foundation rulings,²⁵ having a specialized organization obtain and review information on prospective grantees increases grantmaking efficiency in a way that furthers charitable purposes. The Service reached this conclusion even when the field of grantmaking was a U.S. domestic region, where local grantmakers' own experience often provides a sufficient basis for them to find and identify appropriate grantees on their own, and where IRS recognition of exempt status provides some assurance that grantees are operating exclusively for charitable purposes. The value of a specialized organization collecting and evaluating information about grantees should be even clearer in the much more complicated area of international philanthropy, where language, cultural, and jurisdictional barriers make it much harder for grantmakers without experience to identify and assess the charitable status of grantees, and where the consequences of fund diversion are potentially more serious.

Authorities demonstrating that the Repository's activity is educational

The regulations define the term "educational" to include: "(a) the instruction or training of the individual for the purpose of improving or developing his capabilities; or

²⁵ PLR 200832027 (May 15, 2008); PLR 200832028 (May 15, 2008).

(b) the instruction of the public on subjects useful to the individual and beneficial to the community.”²⁶ In application, this definition includes organizations providing information on a wide variety of topics, even if their specialized nature limits their direct usefulness to the public at large. For example, the Service has recognized organizations educating such groups as bankers, workers, physicians, lawyers, and health care providers as educational organizations.²⁷ Revenue Ruling 75-196²⁸ indicates that an information-providing organization will be considered educational so long as the class benefited is broad enough to warrant a conclusion that the educational facility or activity is serving a broad public interest rather than a private interest.

Not only active instruction but also passive information resources such as libraries and online databases qualify as educational. For instance, both the Service and the courts have recognized law libraries as educational, even when they limit access to members of the local bar association²⁹ or to paying subscribers.³⁰ Because the public benefit produced by educational organizations does not depend on their providing a financial subsidy to those they educate, library access fees and student tuition charges have been held not to prevent an educational organization’s qualification under section 501(c)(3).³¹ In private letter rulings, the Service has applied these principles repeatedly to conclude that building and operating an information resource is an educational activity.³² In one private ruling, the Service concluded that an organization with an extensive collection of information about particular businesses (including information compiled by that organization itself) advanced education by creating a “virtual interactive library” that allowed access to the organization’s collection of works, publications, and data from a personal computer.³³ The organization also assisted users in researching particular

²⁶ Reg. § 1.501(c)(3)-(d)(3).

²⁷ *E.g.*, Rev. Rul. 68-504, 1968-2 C.B. 211 (organization that provided college level instruction in banking-related subjects to the employees of banks in a particular metropolitan area). *See also* Rev. Rul. 67-72, 1967-1 C.B. 125, (organization created by representatives of both labor and management to select individuals for apprentice training, arrange their classroom and on-the-job training and provide books and supplies used for the training); Rev. Rul. 65-298, 1965-2 C.B. 163 (organization disseminating research on human diseases through physicians’ seminars); Rev. Rul. 76-455, 1976-2 C.B. 150, (organization that “educate[d] those involved in furnishing, administering, and financing health care as to the deficiencies in the quality, utilization, and effectiveness of health care and health care agencies,” and that “ma[de] proposals to remedy such deficiencies”); Rev. Rul. 75-196, 1975-1 C.B. 155 (organization operating a law library for members of a local bar association and their designees).

²⁸ 1975-1 C.B. 155.

²⁹ *Id.*

³⁰ *United States v. Proprietors of Social Law Library*, 102 F.2d 481 (1st Cir. 1939).

³¹ *See id.* at 483; GCM 37257 (Sept. 15, 1977).

³² Priv. Ltr. Rul. 9017028 (Jan. 29, 1990); Priv. Ltr. Rul. 9249026 (Sept. 8, 1992); Priv. Ltr. Rul. 9237034 (June 16, 1992); Priv. Ltr. Rul. 9717021 (Apr. 25, 1997); Priv. Ltr. Rul. 8636079 (Jun. 11, 1986).

³³ Priv. Ltr. Rul. 199945062 (Nov. 15, 1999).

inquiries for business information for a fee, developed general forms of data formats which would assist members of the public in addressing their specific business information needs, and advised businesses on developing their own on-site libraries.

Similarly, the Repository will serve educational purposes by gradually building an extensive library of information about charitable organizations all over the world, including governing documents, descriptions of activities, and all other information necessary to determine their public charity status under the standards described above. No doubt many organizations will initially be added to this electronic library of information in response to requests from particular participating grantmakers wishing to make grants to them. However, once their information has been processed and submitted, it will remain accessible as part of the Repository, subject to Repository policies and levels of membership. Thus, in addition to increasing the efficiency and accuracy of equivalency determinations for particular prospective grantees identified by grantmakers, the Repository will become an unparalleled source of information about organizations meeting U.S. charitable standards all over the world, one which grantmakers will be able to use in order to learn more about organizations pursuing charitable activities that align with those grantmakers' specific priorities.

As an electronic information repository, the Repository is clearly an electronic "library" in every sense of the word. Its collection will be a unique reservoir of information on the activities, legal structure, and finances of an ever-increasing number of charities worldwide. As *Proprietors of Social Law Library* and Revenue Ruling 75-196 make plain, the fact that the Repository is targeted to a specific audience and charges a fee for access to its information does not alter the educational nature of the materials provided.³⁴ *Proprietors of Social Law Library* determined that the law library in question was exempt in part because of the public interest in providing lawyers with the best possible informational resources in order to aid the administration of justice, even though such aid would also benefit the lawyers in their private practices.³⁵ Here, there is an equally clear public interest in providing U.S. grantmakers with information on prospective grantees, which will help ensure that charitable grants are made to appropriate foreign charities meeting all applicable U.S. standards.

At the same time, because the Repository is specifically designed to provide 501(c)(3) grantmakers with the information they need to make foreign grants, its beneficiaries will largely consist of 501(c)(3) organizations. Thus, the Repository will be

³⁴ *Proprietors of Social Law Library*, 102 F.2d at 483; Rev. Rul. 75-196, 1975-1 C.B. 155.

³⁵ *Proprietors of Social Law Library*, 102 F.2d at 484.

focused on serving charities in place of the many private legal practices served in *Proprietors of Social Law Library* and Revenue Ruling 75-196. In this respect, the Repository presents an easier case for section 501(c)(3) status than the libraries approved by those authorities. In operation, it will emerge as a large online database of information on charities and nonprofits that have applied to the Repository for recognition as charities. As the Service ruled in Private Letter Ruling 199945062, such a database of organizations can qualify as educational, even when it focuses on information about for-profit businesses and even though its staff provides tailored research to meet the needs of particular online users. The result should be even clearer in this case, where the Repository is designed to provide information about charities.

The fact that some for-profit service providers perform equivalency determinations should not affect the charitable status of the Repository or its liability for UBIT.

In our meeting, you pointed out that law firms and similar for-profit enterprises currently perform equivalency determinations. It should be stressed that TechSoup Global's operation of the Repository will not constitute the provision of an ordinarily available commercial service. Repository users will have access to a whole library of information on an ever-increasing number of foreign organizations; while individual users may request the inclusion of particular grantees for a fee, the information about those grantees becomes a permanently available resource for the charitable community. This equivalency determination database is far different from the case-by-case confidential analysis that law firms typically provide.

Quite simply, in the forty years since section 4945 has passed, no commercial providers of such a repository have emerged, and it is our belief that no such repository could be economically feasible without significant donative support. While TechSoup Global aims to operate the Repository on a self-sustaining basis, its fees are not designed to recoup the significant expense it has and will incur in the development of the Repository, and indeed are not expected to cover current operational expenses until 2014. Thus, it cannot be claimed that there is any substantial profit purpose behind the creation and operation of the Repository. Rather, from the start, the driving force behind the Repository has been the grantmaking community's strongly felt need for a more efficient way of performing equivalency determinations and for centralizing and sharing information about foreign grantees. Accordingly, the operation of the Repository is readily distinguishable from the provision of commercial services at issue in *B.S.W. Group* and Revenue Ruling 72-369, described above.

In addition, in the "unrelated business" context, it is recognized that the mere fact that for-profits provide similar services does not automatically convert charitable activity

into unrelated business activity. Section 513(a)(1) of the Code provides that the term “unrelated trade or business” means, in the case of any organization subject to the tax imposed by section 511, income from any trade or business, the conduct of which is not substantially related (aside from the need of such organizations for the income or funds or the use it makes of the profits derived) to the exercise or performance of such organization of its charitable, educational, or other exempt purpose constituting the basis of its exemption under section 501.

Treasury Regulation § 1.513-1(d)(2) provides that a trade or business is “related” to exempt purposes, in the relevant sense, only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes (other than through the production of income), and it is “substantially related” for purposes of section 513 only if the causal relationship is a substantial one. The regulation further clarifies, “[t]hus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to the purposes for which exemption is granted . . . the performance of services from which gross income is derived must contribute importantly to the accomplishment of those purposes.” Treasury Regulation 1.513-1(c)(3) adds that, to the extent an activity is conducted on a larger scale than necessary for performance of an organization’s exempt functions, it is not substantially related to those functions.

In determining whether an activity is an unrelated trade or business, several courts have looked to the underlying purposes of the tax (preventing unfair competition with similarly situated taxable businesses). According to these courts, if an activity does not compete with taxable businesses, that may weigh against considering the activity a “trade or business” subject to UBIT under section 513.³⁶ Other courts, following the regulations, have held that the term “trade or business” includes any activity that would be a trade or business under section 162, regardless of whether it competes with taxable businesses.³⁷ However, *neither* line of cases suggests that competition should be used as a factor in determining whether a trade or business is “not substantially related” and thus subject to UBIT. Such an interpretation seems foreclosed by the regulations, which state as follows:

³⁶ *See, e.g.*, *Hope School v. United States*, 612 F.2d 298 (7th Cir. 1980); *see also* *Disabled American Veterans v. United States*, 650 F.2d 1178 (Ct.Cl. 1980).

³⁷ *See, e.g.*, *Prof’l Ins. Agents v. Comm’r*, 726 F.2d 1097 (6th Cir. 1984); *Carolinas Farm & Power Equipment Dealers v. United States*, 699 F.2d 167 (4th Cir. 1983); *Louisiana Credit Union League v. United States*, 693 F.2d 525 (5th Cir. 1982); *cf.* *Treas. Reg. 1.513-1(b)*.

[I]n general, any activity of a section 511 organization which is carried on for the production of income and which otherwise possesses the characteristics required to constitute “trade or business” within the meaning of section 162—and which, in addition, is not substantially related to the performance of exempt functions—presents sufficient likelihood of unfair competition to be within the policy of the tax.³⁸

Here, the regulations go out of their way to stipulate that a trade or business must be unrelated to exempt purposes before it will present a sufficient likelihood of unfair competition to be subject to UBIT. It would be circular to determine whether an activity is substantially related to exempt purposes based on its competition with taxable businesses. Indeed, in 1987, then-IRS Commissioner Lawrence B. Gibbs testified to Congress that “currently, the statute and regulations do not require the Service to consider competition in determining exempt status or application of the unrelated business income tax.”³⁹ No intervening change in the statute or regulations has altered that fact, and organizations like hospitals and universities continue to pay no tax on their substantially related business activities, even though such institutions increasingly find themselves in competition with for-profit counterparts.

In the trade association context, some courts have determined whether an activity is “substantially related” by determining whether it provided services “unique to the organization’s tax-exempt purpose” rather than generic commercial services typically provided by for-profit companies.⁴⁰ This comparison with for-profit service providers may be specific to the 501(c)(6) context, where conducting business activities normally conducted by for-profits is expressly prohibited.⁴¹ But to the extent these cases have relevance in the 501(c)(3) context, they draw a distinction between ordinary commercial services already available in the market and useful to a broad range of persons and services of specific relevance to the organization’s charitable purposes. For instance, in *Louisiana Credit Union League v. Commissioner*, perhaps the leading case on this point, the provision of insurance was considered a generic commercial service subject to UBIT, and was contrasted with the publication of a looseleaf library service providing information

³⁸ Treas. Reg. § 1.513-1(b) (emphasis added).

³⁹ Unrelated Business Income Tax: Hearings Before the Subcommittee on Oversight of the House Committee on Ways and Means, 100th Cong. 69 (1987).

⁴⁰ See, e.g., *Illinois Ass’n of Prof’l Ins. Agents v. Comm’r*, 801 F.2d 987 (7th Cir. 1986); *Carolinas Farm*, 699 F.2d at 171; *Louisiana Credit Union League v. United States*, 693 F.2d 525, 535 (5th Cir. 1982); *Steamship Trade Ass’n v. Comm’r*, 757 F.2d 1494, 1497-98 (4th Cir. 1985).

⁴¹ Treas. Reg. § 1.501(c)(6)-1.

about the laws and regulations affecting a 501(c)(6) organization's particular line of industry.⁴² The latter was "unique" to the organization's exempt purpose in the sense that the nature of the materials was specifically tailored to the needs of the industry in question. As a result, it would be primarily useful to members of that industry, and would not normally be available through independent commercial channels.⁴³ As discussed in the previous section, the Service has ruled that gathering and evaluating information about potential grantees to increase the efficiency of charitable grantmaking is sufficiently tailored to exempt purposes to be a "substantially related" trade or business.⁴⁴

Under these standards, the Repository's activities are substantially related to the exempt purposes of its operator, TechSoup Global, Inc. ("TechSoup"). TechSoup's core exempt purpose has been to build the capacity of nonprofits worldwide by providing the education, knowledge, technology and resources they need to accomplish their missions effectively. By leveraging its technological expertise and global network of partners to create a more efficient equivalency determination process for U.S. grantmakers, it is substantially furthering that mission. Moreover, as explained above, developing and maintaining the Repository as an informational and technological tool to increase the efficiency of U.S. grantmaking is an activity that constitutes an independently valid basis for TechSoup's exemption under section 501(c)(3). By increasing the efficiency of charitable grantmaking and by making accurate informational resources available to charities and others, operation of the Repository will "contribute importantly" to the furtherance of that exempt purpose. Moreover, the Repository's activity easily qualifies as a service uniquely tailored to meet charitable needs, not a commercial service generally available to the broader public that TechSoup happens to provide to charities. Indeed, this service is very similar to the pre-grant information collection and evaluation that the Service recently ruled was a substantially related business for two community foundations.⁴⁵ In that ruling, the Service expressly distinguished such services from more general administrative and clerical services not as closely tied to the facilitation of efficient charitable giving. Similarly, TechSoup's operation of the Repository is substantially related to its exempt purposes and is not subject to UBIT.

Other repositories may not qualify for exemption under 501(c)(3) standards

⁴² *Louisiana Credit Union League*, 693 F.2d at 535.

⁴³ *Id.*

⁴⁴ Priv. Ltr. Rul. 200832027; Priv. Ltr. Rul. 200832028.

⁴⁵ Priv. Ltr. Rul. 200832027; Priv. Ltr. Rul. 200832028.

The foregoing analysis sets forth in detail the authorities that persuade us that the planned Repository will operate comfortably as a 501(c)(3) organization and without unrelated business exposure. We do not mean to suggest that all conceivable EDIRs would qualify as charitable organizations. For instance, if an EDIR were set up solely as a front to attract business for a commercial equivalency determination provider, existing rules proscribing private benefit would preclude 501(c)(3) status for that organization.⁴⁶ Similarly, if a proposed EDIR collected fees sufficient to earn significant profits even without donative startup support, at some point the “commercial hue” of its activities might disqualify it from 501(c)(3) status, as would improper distributions of repository-related earnings to insiders. Thus, we believe that the requirement that any EDIR be a section 501(c)(3) organization will provide a natural way of ensuring that EDIRs operate to produce a public benefit for the charitable sector rather than private wealth. For instance, this requirement helps ensure that the efficiency savings that result as the volume of EDIR users increases will be used to further charitable purposes such as improving operation of the EDIR or reducing the cost of using it, not to increase private profits.

III. Enforcement Concerns

Understandably, throughout our discussions with the IRS about the possibility of allowing grantmakers to rely on information and analysis provided by an EDIR, a major focus of the IRS has been to make sure that doing so would not compromise its ability to enforce federal tax law and to ensure that charitable assets are used for appropriate exempt purposes. In particular, the IRS has expressed concern that it would be unable to impose excise taxes against a private foundation that made a grant to a foreign organization in reliance on an incorrect equivalency determination issued by an EDIR.

While the addition of EDIRs as a source of reliable information about charities will change the set of enforcement options available to the Service, we believe that the Service will still have adequate options to ensure at least as high a level of tax compliance as previously existed under section 4945, and sufficient to accomplish Congress’s objectives in passing section 4945.

Structure and purpose of section 4945

⁴⁶ See Treas. Reg. § 1.501(c)(3)-1(d)(1)(iii), ex. 3; *Church by Mail v. Comm’r*, 765 F.2d 1387 (9th Cir. 1985); *est of Hawaii v. Comm’r*, 71 T.C. 1067 (1979).

Section 4945 was enacted to ensure that private foundation grantmakers would take reasonable precautions against their funds being spent for a variety of nonexempt purposes. Prior to its enactment, some foundations made grants to non-charitable organizations that were ultimately used for non-exempt activities, such as vacations abroad for staff, paid interludes between jobs, and preparation of materials promoting specific political viewpoints.⁴⁷ These foundations would often disclaim responsibility for how their funds had been spent, asserting that they were not accountable for any improper use. At the same time, the recipients might be non-exempt entities that were not normally subject to any sanction for noncharitable expenditures. And even when the recipient was a 501(c)(3) organization, an isolated grant for noncharitable purposes was often an insubstantial enough portion of the organization's overall activities that revocation of the grantor's or grantee's tax-exempt status was not a realistic option.⁴⁸

In response, section 4945 imposes an excise tax on specific expenditures, regardless of whether such expenditures are substantial enough to warrant revocation of exempt status. It considered barring all grants to organizations not described in section 501(c)(3), which would have guaranteed that the IRS could have held either the grantor or the grantee responsible for any misused funds.⁴⁹ However, it ultimately chose a more "flexible" approach.⁵⁰ For grants to noncharities or private foundations (now extended to include certain supporting organizations), sections 4945(d)(4) and 4945(h) imposed an excise tax—now 20% of the grant payment—but only if the foundation failed to "exert all reasonable efforts and establish adequate procedures" to ensure that the grant was spent properly, obtain proper reports, and report to the IRS as required by regulation. Section 4945 and the regulations interpreting it explicitly stop short of imposing strict liability on foundations for any diversion of grant funds, instead imposing a duty of reasonable care coupled with prescriptions as to specific procedures necessary to satisfy that standard. If those standards are followed, no liability attaches.

For public charity grantees, the IRS did not impose the same detailed expenditure responsibility requirements. However, that does not mean that it absolved private foundations of all responsibility for how public charities used the private foundations' funds. Rather, the regulations make clear that, in the typical case of a grant earmarked to accomplish some specific purpose (usually, the purpose described in the grant proposal),

⁴⁷ Staff of the Joint Comm. on Taxation, 91st Cong., 2d Sess., General Explanation of the Tax Reform Act of 1969, at 48 (Comm. Print 1970).

⁴⁸ S. Rep. No. 552, 91st Cong., 2d Sess. 48, 51 (1969).

⁴⁹; H.R. Rep. No. 413 (Part 1), 91st Cong., 2d Sess. 33, 35 (1969).

⁵⁰ *Id.*

the private foundation can be held liable under section 4945(d)(5) if that specific activity is not exclusively charitable within the meaning of section 170(c)(2)(B).⁵¹ Of course, a grantee planning on using funds for noncharitable activity may misdescribe that activity to make it seem as innocent as possible. While the regulations under section 4945(d)(5) do not specifically address a foundation's duty of care in such circumstances, the parallel regulations regarding private foundations' responsibility for lobbying expenditures made with their grant funds do. Even when a public charity provides documentation (including affidavits) that no grant funds earmarked for a particular project will be allocable to lobbying activity, the grantor cannot rely on that representation if the grantor "doubts or, in light of all the facts and circumstances, reasonably should doubt the accuracy or reliability of the documents."⁵² Here again, section 4945 imposes a reasonable care standard on foundation grantees, allowing them to rely on grantee representations when there is no reason to doubt them, but providing no refuge for the foundation that turns a blind eye to information in its possession that would cause it to doubt that a particular grantee will spend its grant funds properly. We see no reason why the standard should not be the same for other categories of impermissible expenditure.

In the case of foreign grantees without an IRS determination letter, the regulations again stop short of a strict liability standard. A grantmaking foundation is not liable for excise tax under section 4945(d)(4) so long as it has made a "reasonable judgment" that the organization is described in section 501(c)(3), and a "good faith" determination that the organization is a public charity of the kind described in section 4945(d)(4).⁵³ In making these determinations, a private foundation is explicitly allowed to rely on affidavits from the grantee, and Revenue Procedure 92-94 confirms that such affidavits can be quite conclusory in form, containing rote statements that the organization is organized exclusively for charitable purposes, that it is prohibited from engaging in political campaign intervention or substantial attempts to influence legislation, and so forth. If these representations are inaccurate, a foundation is normally not liable unless it failed to take into account information suggesting that the grantee's affidavit may not be valid.

In contrast to the rules governing expenditure responsibility, the regulations authorizing equivalency determinations impose no specific procedures for how

⁵¹ I.R.C. § 4945(d)(5); Treas. Reg. § 53.4945-2(a)(5)(i).

⁵² Treas. Reg. § 53.4945-2(a)(6)(iii).

⁵³ Treas. Reg. § 53.4945-6(c)(2)(ii); Treas. Reg. § 53.4945-5(a)(5). Note that the regulations still have not been updated to reflect the current language of section 4945(d)(4), which now has been extended to impose penalties on grants to certain supporting organizations unless the private foundation exercises expenditure responsibility.

equivalency affidavits should be evaluated, and provide the IRS very limited options for relief if a grantor makes an incorrect equivalency determination. If the foundation makes a mistake in applying the tests for 501(c)(3) status, the IRS has no remedy unless the error is not only wrong but beyond the bounds of a reasonable judgment. If the mistake is in determining public charity status, even *unreasonable* errors do not give rise to section 4945 excise tax—all that is required is that the grantee’s determination was made in good faith (i.e., the grantee was legitimately trying to make a correct assessment), no matter how erroneous a methodology the grantee in fact used. Moreover, so long as a foundation has no information that would suggest that the affidavit may not be reliable, it cannot be held liable simply because the grantee’s representations turn out to be false;⁵⁴ ordinarily, there is no requirement to engage in independent investigation to confirm that the affidavit’s representations are accurate.

Sanctions available under the proposed revisions to Revenue Procedure 92-94

Any adequate regime for enforcing section 4945 (and now the parallel provisions of section 4966) should enable the IRS to make sure that foreign grantmaking is carried on in accordance with section 4945’s core insistence on reasonable efforts and adequate procedures to protect against diversion of charitable funds. Ideally, the IRS would be able to prevent violations of this principle *ex ante*, but it must also have the ability to promote tax compliance with the threat of sanctions administered *ex post* if these norms are violated. The sanctions regime should also be flexible enough to distinguish between those intentionally abusing the rules and those attempting in good faith to comply.

The current regime for equivalency determinations relies almost entirely on the threat of *ex post* sanctions to produce compliance. Grantmakers are free to use a variety of methods or procedures to determine whether a foreign grantee meets U.S. standards. Many grantmakers try to stay within the safe harbors of Revenue Procedure 92-94, but while it provides fairly concrete guidance about the information that grantmakers should collect, it leaves grantmakers free to decide how they should evaluate that information once they obtain it. Thus, even if they are aware of the equivalency determination standards and attempting to comply with them, U.S. grantmakers (particularly those without extensive knowledge of the tax classifications of charities) may arrive at very different ideas about what constitutes a reasonable approach to equivalency determinations. Add to this the fact that section 4945 penalties apply only in extreme cases when the equivalency determination is beyond the bounds of a reasonable judgment (in the case of the 501(c)(3) determination) or is not made in good faith. In our

⁵⁴ Rev. Proc. 92-94, 1992-1 C.B. 507, § 4.01

experience, such penalties are imposed extremely rarely in practice. As a result, section 4945 is a relatively weak device for ensuring tax compliance.

If Treasury adopts the proposal to allow grantmakers to rely on EDIRs, the IRS will be able to exert considerably more control over the equivalency determination process:

- **Continued grantmaker liability.** In the first place, as discussed above, even with an equivalency certificate in hand, grantmakers will continue to have potential liability under section 4945(d)(5) if they make a grant for a specific project and the proposal gives them reason to doubt that the funds will be spent in furtherance of exempt purposes. Thus, in the case of an actual diversion of funds, nothing would prevent the IRS from auditing the grantmaker itself to determine whether it had information in its possession that should have caused it to question how its funds would be used. Furthermore, while a grantmaker would normally be able to rely on an EDIR's confirmation that other legal requirements for public charity status were met, as in other contexts, this would not allow a grantmaker to ignore contrary information in its possession. Rather, if a grantmaker were actually aware of (or responsible for) acts of the grantee inconsistent with the grantee's status according to the equivalency certificate—even if the acts in question were not funded by the grantmaker—the grantmaker could not rely on an EDIR's determination, and could be subject to tax under section 4945(d)(4) as well.
- **Ex ante control over procedures used by EDIRs.** A major advantage of the new procedure, which is completely lacking under current law, is the opportunity for the IRS to review EDIRs' equivalency procedures in advance. Instead of encouraging each foundation to make equivalency determinations in accordance with whatever procedures are reasonable by its own lights, the attractiveness of the EDIR option will provide a considerable incentive for foundations to rely on equivalencies performed according to EDIR standards approved in advance by the IRS. We believe this ability to channel grantmakers into using adequate equivalency standards *ab initio* is a valuable compliance tool, one that more than makes up for any lost ability to punish grantmakers after the fact for not developing such standards on their own.
- **Easier ability to make prospective changes.** Currently, there is no easy way for the IRS to make global adjustments to equivalency standards applied by charities. If a centralized Repository gains traction, however, the IRS could examine that one entity and, if it identified any problems in its procedures, it could require correction of such problems as a condition of maintaining EDIR status—effectively

changing the standards applied by all grantmakers using that EDIR. Moreover, under our draft revenue procedure, the IRS would retain great flexibility to revoke individual equivalency certificates not meeting the applicable standards, or to revoke all equivalency determinations made by a particular EDIR.

- **EDIRs would be subject to a variety of sanctions that would ensure their diligence in following their IRS-approved procedures.** We believe that a primary driver of IRS concerns about allowing EDIRs is that, even if their approved procedures were sufficiently rigorous, they would have little incentive to apply those procedures strictly once they gained EDIR status, given that neither they nor the grantmakers they serve would be subject to penalty if they did not. We agree that it is essential to be able to hold EDIRs properly accountable for any divergences from their stated procedures. However, in fact the IRS has a variety of other tools at its disposal to punish either individual lapses or global laxity in following those procedures:

- *Liability for false statements.* An EDIR effectively certifies to each grantmaker that it has complied with its IRS-approved procedures and determined that the proposed grantee has a given tax status. If an EDIR knowingly made those certifications even though it actually had not complied with its agreed-upon procedures, it could be subject to civil penalties under section 6701 for aiding and abetting an understatement of federal tax liability.⁵⁵ The penalties are up to \$10,000 per year per grantmaker relying on a particular equivalency certificate to avoid section 4945 excise tax penalties for such year (\$1,000 per year for non-corporate grantmakers).⁵⁶ Furthermore, if these penalties are not enough, the EDIR could be required to state on the equivalency certificate, under penalties of perjury, that the EDIR had complied with its IRS-approved procedures in reaching its conclusion. If the EDIR issues such a certificate knowing that it had not in fact complied with the relevant procedures, it could be subject to criminal penalties under section 7206(1) equal to up to \$500,000 (if

⁵⁵ Section 6701(a) of the Code imposes a penalty on any person who aids in the preparation of an affidavit or other document, knows that such document will be used in connection with a material matter arising under the internal revenue laws, and knows (or has reason to believe) that such use would result in the understatement of tax of another person. Although it can be argued that this penalty should not apply because a person relying on an EDIR's equivalency certificate avoids section 4945 tax and thus does not understate any tax due as a result of reliance on the EDIR, we believe that this kind of bootstrapping argument should not be successful. The better analysis, we believe, is that section 6701 applies because as a result of the EDIR's equivalency certificate, grantmakers understate their section 4945 tax relative to the amount that would have had to be stated if the EDIR had not made its false statement.

⁵⁶ I.R.C. § 6701(b).

the EDIR is a corporation). Moreover, if the EDIR lied to the IRS about the procedures it intended to follow, it could be criminally prosecuted for making false statements to the government under 18 U.S.C. § 1001(a)(2).⁵⁷ Intentionally false statements or omissions made to either the government or grantmakers could also be punished under I.R.C. § 7212 as corrupt endeavors to impede the due administration of the tax code.

- *Personal liability of individual employees of an EDIR.* Most of the foregoing penalties can be imposed against the individual employees of an EDIR responsible for issuing an equivalency certificate containing false statements. In addition, our draft revenue procedure requires equivalency certificates to be issued under the supervision of a federally authorized tax practitioner, who would be subject to the requirements of Circular 230. Notably, such a practitioner could be subject to professional responsibility sanctions not only for cases of knowing departures from the EDIR's procedures, but also failures to exercise due diligence or to exercise "reasonable care in engaging, supervising, [or] training" those under the practitioner's supervision on whose work the practitioner relies in making equivalency determinations.⁵⁸
- *Revocation of EDIR status.* If the IRS discovers information that indicates that an EDIR is not in substantial compliance with its IRS-approved procedures, or that its equivalency determinations do not meet the applicable standards of correctness under the regulations, the IRS can revoke the organization's EDIR status. In the case of an abusive EDIR intentionally certifying charities without regard for proper procedures, we would expect such revocation as a matter of course, perhaps in conjunction with imposition of some of the civil or criminal penalties mentioned above. However, the IRS would also be able to revoke EDIR status even if the EDIR were attempting in good faith to comply its specified procedures but had, in the eyes of the IRS, failed to do so. Given the considerable capital investment

⁵⁷ See *United States v. Mubayyid*, 567 F. Supp. 2d 223 (D. Mass. 2008) (applying these statutes in the charitable context when an organization failed to disclose certain activities on its Form 990).

⁵⁸ See 31 C.F.R. § 10.22.

necessary to operate an EDIR, we believe this sanction would be a real threat to an existing EDIR.

- *Revocation of Exempt Status.* An activity that would otherwise be charitable will not be considered charitable if it is “illegal, contrary to a clearly defined and established public policy, or in conflict with express statutory restrictions.”⁵⁹ Thus, for example, an organization that sought to foster world peace was not charitable when it encouraged acts of civil disobedience at its protests because such acts were in violation of law.⁶⁰ If an EDIR issues equivalency certificates that are clearly incorrect, it would be misleading rather than educating the charitable community. Moreover, it would be encouraging grantmakers to make grants without exercising expenditure responsibility as required by sections 4945 and 4966 as well as analogous prohibitions in many state laws. Encouragement of illegal activities, even in pursuit of charitable purposes, does not qualify as charitable. If such erroneous determinations constituted a substantial part of the EDIR’s activities, the EDIR would not be operated exclusively for exempt purposes, and would not qualify as exempt under section 501(c)(3).
- *Imposition of UBIT.* Section 513(a) of the Code provides a “fragmentation rule” that “an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization.” Thus, for example, even if most items for sale in a gift shop are related to an organization’s charitable purposes, sales of any non-related items will result in unrelated business income tax.⁶¹ Similarly, even in cases where the Service decides that more extreme civil or criminal penalties should not apply to an EDIR, the Service could require the EDIR to pay UBIT on its income from any equivalency determinations that the Service determined to be clearly incorrect.

⁵⁹ Rev. Rul. 80-278, 1980-2 C.B. 175-76.

⁶⁰ Rev. Rul. 75-384, 1975-2 C.B. 204.

⁶¹ Rev. Rul. 73-105, 1973-1 C.B. 264.

We believe this menu of enforcement options should be adequate. Private foundations and grantmakers subject to section 4966 will continue to be responsible for their own direct knowledge about their grantees and what they reasonably should expect those grantees to do with their funds. And EDIRs will have no opportunity to slacken their efforts to use reasonable procedures in conducting equivalency determinations, because they must truthfully certify that those procedures have been followed, because the supervising tax practitioners could be directly sanctioned for failure to exercise reasonable due diligence, and because more than occasional errors could effectively cause them to lose their investment in their EDIR operations or even their exempt status. In short, the IRS has ample means to punish both egregious isolated failures as well as systematic deficiencies in an EDIR's equivalency determination process.

It is true that the IRS may not be able to impose large fines or revoke EDIR or exempt status for a few isolated reasonable mistakes, even if those mistakes lead to diversion of charitable funds. But that is no different than under current law, which refuses to impose strict liability for diversions of grant funds when grantmakers have made reasonable efforts to determine a foreign charity's public charity status and to determine that the specific funded project will be charitable. The difference will be that an EDIR will have a much more specific set of procedures against which to measure its reasonable efforts than would a grantmaker subject to the general reasonable judgment and good faith standards. The concreteness of an EDIR's standards should actually make it easier to police departures from proper procedures than under current law.

Finally, it is worth stressing that section 4945 does not exist in a vacuum, and depending on the kind of diversion of foreign grant funds, other laws might be as effective or more effective at stopping abuse or encouraging reasonable prevention efforts. For instance, in recent years Treasury has been particularly concerned about diversion of foreign charitable grants to funding terrorism. It is worth noting that a grantmaker who knowingly provided material support to terrorists, or who provided grant funding to persons listed by the Office of Foreign Assets Control as specially designated nationals, would be subject to sanctions whether or not the grantmaker had an equivalency certificate from an EDIR.⁶²

Information gathering possibilities

Proper enforcement of the equivalency determination process depends not only on a set of sanctions to punish past violations and stop ongoing reliance on bad equivalency

⁶² See, e.g., 18 U.S.C. §§ 2339A, 2339B, 2339C; Executive Order 13324 (Sept. 23, 2001).

determinations or EDIRs, but also on the Service's ability to identify instances in which those sanctions should apply. In some cases, this is not an issue, for instance when the IRS is responding to public reports of egregious diversions of funds by foreign grantees. In such circumstances, the IRS could examine the grantmaker involved, and hold the grantmaker responsible if it knew or reasonably should have known that the funded project would involve nonexempt activities. If the grantmaker had no reason to suspect such a misuse of funds would occur and relied on an EDIR's equivalency certificate, the IRS could then examine the EDIR and apply any appropriate sanctions based on that specific equivalency determination or based on the EDIR's overall pattern of equivalency determination activity.

More frequently, though, there will be no public scandal alerting the IRS to a problem with an equivalency determination, in which case the Service's tools for finding such problems on its own become of paramount importance. We believe that the centralization of the equivalency determination process in what we expect would be relatively few EDIRs will make it far simpler for the IRS to check that equivalency determinations are made in accordance with appropriate standards, allowing the IRS to substitute a global review of an EDIR's operations for case-by-case review of individualized determinations made by each separate grantmaker. (Of course, grantmakers' own grants in the face of facts suggesting that their funds would be misused could still be penalized in individual audits of particular grantmakers, and would still be reportable on individual grantmakers' Forms 4720.)

Appropriate changes to the instructions of Form 990 could further aid the IRS in identifying EDIRs that are likely candidates for audit. For instance, the instructions could instruct grantmakers to provide a list on Schedule O of grantees for which the grantmaker was relying on an EDIR's equivalency certificate, and the name of the EDIR providing such certificates. Likewise, an EDIR itself could be required to provide a schedule of equivalency determinations performed and the number of grantmakers to whom equivalency certificates had been provided. And it could be required to disclose any equivalency determinations that it had discovered were erroneous, together with the steps the EDIR took to remedy the error (such as informing grantmakers and revoking the equivalency certificate). Finally, we note that the draft revenue procedure currently calls for periodic external reviews of an EDIR's operations. The IRS could require that EDIRs post the results of such reviews publicly, or require them to be submitted to the IRS. All of these measures could help generate a record that would alert a reviewing agent to any potential problems with the EDIR's equivalency determination process.

IV. Conclusion

We hope the foregoing discussion is responsive to your questions and concerns raised at our most recent meeting. We continue to believe that authorizing EDIRs such as the Repository would create significant benefits for the substantial portion of U.S. charities engaging in international philanthropy, while at the same time providing the IRS with increased means to ensure that equivalency determinations are performed in accordance with appropriately standards. If there are specific changes to our draft procedure that would be helpful to ensure that both the government and the charitable sector would realize these potential benefits, we would welcome the chance to discuss them.

We would also appreciate the chance to touch bases with you in the relatively near future to learn whether you have had the chance to discuss our proposal with other decision makers at Treasury, and to see if there are any other areas of concern to which we could usefully respond. Given the various ways that subsequent legal changes have rendered Revenue Procedure 92-94 out of date, we believe that the sooner it can be updated, the better it will be for the charitable sector.

Sincerely,

A handwritten signature in black ink, reading "Janne Gallagher", followed by a long horizontal flourish line extending to the right.

Janne G. Gallagher
Vice President and General Counsel