COUNCIL *on* FOUNDATIONS

May 31, 2017

Via Hand Delivery

Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2017-26)
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

RE: **Recommendations for 2017-2018 Priority Guidance Plan Notice 2017-26 - International**

Dear Ladies and Gentlemen:

The Council on Foundations believes that updated guidance from Treasury on the matters set forth in our letter of May 1, 2016, some of which are reiterated here along with a few new requests, is of increasing importance to international philanthropy. The members of the Council are concerned that the continued absence of guidance is having a negative impact on the ability of U.S. grantmaking organizations to ensure that their operations are in full compliance with the requirements of the law. To that end, we again offer our recommendations with regard to the Priority Guidance Plan.

Pursuant to the request for comments published in Notice 2017-26, I write to urge the Internal Revenue Service and the Department of the Treasury's Office of Tax Policy to include in their 2017-18 Priority Guidance Plan an update to Revenue Procedure 92-94.[1] We appreciate that Treasury has already indicated its commitment to updating the Revenue Procedure, and we ask that this be included as a priority for 2017.

Revenue Procedure 92-94 currently sets forth acceptable procedures for grantmakers to follow in making "equivalency determinations" determining the U.S. tax classification of their foreign grantees. We thank Treasury for its guidance on when grantmaking organizations may rely on equivalency determination opinions by qualified tax professionals,[2] which has significantly reduced burdens on foreign grantmaking. However, because Revenue Procedure 92-94 is still the only authoritative guidance about the substance of the equivalency determination process, it is important for it to be updated in order to resolve potential controversy over its application given intervening changes in the law, and to resolve various longstanding questions about the application of U.S. rules to foreign organizations.

[1] 1992-1 C.B. 507.
[2] Reliance Standards for Making Good Faith Determinations, 80 Fed. Reg. 24346 (September 25, 2015) (amending Treas. Reg. §§ 53.4942(a)-(3)(a)(6) and 53.4945-5(a)(5)).

We would also recommend that Treasury and the IRS update their guidance relating to grants to Mexican charities under the U.S.-Mexico Income Tax Convention (the "Treaty") in light of changes to Mexican law, in order to identify the core set of Mexican charities under Mexican law that can continue to be treated as eligible for benefits under the Treaty.

We request that the IRS modify the definition of "withholdable payment" under the Foreign Account Tax Compliance Act (FATCA) to include grants from Section 501(c) organizations on the list of nonfinancial payments not treated as withholdable payments, as scholarships, prizes, awards, and payments for services are listed currently.

We request that Treasury prioritize bank derisking efforts to enable civil society organizations to deliver humanitarian assistance using the banking system without undue delay from banking due diligence to comply with federal anti-terrorist financing and anti-money laundering rules.

Finally, we request that Treasury issue a general license to address the looming humanitarian crisis in South Sudan, Somalia, Yemen, and northeast Nigeria which are facing one of the worst famines in history.

Suggested Updates to Revenue Procedure 92-94

For over twenty years, Revenue Procedure 92-94 has been the primary source of guidance for grantmakers about the type of information that should be gathered in order to support an equivalency determination. Setting forth this information in a revenue procedure has been important because it has allowed the IRS to maintain a general good faith standard in the regulations that is flexible enough to be applied case by case to the endless variety of situations confronting international grantmakers, while still prescribing a relatively clear model package of information that grantmakers should obtain (and which grantmakers are encouraged to obtain in order to qualify for its safe harbor). Prior to the advent of Revenue Procedure 92-94, many grantmakers were discouraged from participating in international philanthropy because they were not sure what kind of information the IRS might, in a retrospective audit, decide that they should have obtained as a basis for their equivalency determinations. Revenue Procedure 92-94 quieted those concerns while having a powerful effect as a standard-setting document.

Revenue Procedure 92-94 is showing its age, however, as US law marches on. A significant amount of friction in international grantmaking could be avoided with additional clarifications surrounding a few questions commonly affecting equivalency determinations. Many of these issues have been raised previously as subjects ripe for clarification by the Council on Foundations, TechSoup Global, the Tax Section of the American Bar Association, leading private foundations, and by the Advisory Committee for Tax-Exempt and Government Entities.[3] In most cases, the wording changes necessary to make these clarifications are quite simple. An

[3] *See* Letter from Steve Gunderson, President, Council on Foundations to Michael Mundaca, Acting Assistant Secretary for Tax Policy, Department of the Treasury (Dec. 28, 2009); Letter from Michael Hirschfeld on behalf of the American Bar Association Section of Taxation to Daniel Werfel, Acting Commissioner of the IRS (Aug, 14, 2013), 2013 Tax Notes Today 158–18; Advisory Committee on Tax-Exempt and Government Entities, *Exempt Organizations: Recommendations to Improve the Tax Rules Governing International Grantmaking* 14-20 (2009).

update to Revenue Procedure 92-94 addressing these issues should be placed on the Priority Guidance Plan for 2017-18.

Without restating the full rationale for all of the changes that have been repeatedly proposed over the years, the principal corrections and changes we would recommend may be summarized as follows:

- **New Organizations within the first five years of existence.** The IRS did away with the "advance ruling period" effective June 9, 2008. Under the new rules, an organization is deemed to be a public charity for the first five years of existence. We recommend that Revenue Procedure 92-94 be updated to allow a grantmaker conducting an equivalency determination to apply current law to determine whether a newly created foreign organization will meet the applicable public support test under Sections 170(b)(1)(A)(vi) or 509(a)(2), specifically to determine whether there is a "reasonable expectation" that the organization will meet the relevant test at the end of the organization's first five years of existence.[4]

- **Equivalency for international organizations, foreign government instrumentalities, etc.** Confirm that a grantmaker can also make a good faith determination that a grantee is an international organization, foreign government instrumentality, foreign public university, or other entity treated as a public charity under Treasury Regulations Section 53.4945-5(a)(4).

- **Public support from certain foreign governments and public charities.** Clarify that a grantmaker evaluating the public support of a foreign organization may treat as 100 percent public support under the Section 170(b)(1)(A)(vi) test all support from other foreign charities meeting that public support test or from the United Nations, foreign governments, foreign government instrumentalities, and foreign public universities, as would be the case for funding received from a domestic government entity or Section 170(b)(1)(A)(vi) public charity.[5]

- **No requirement to restrict lobbying in governing documents.** Make clear that foreign organizations that have demonstrated through historic practice that they do not engage in political campaign intervention or substantial lobbying activities comply with Section 501(c)(3), even if their governing documents and local law do not expressly forbid them from engaging in these activities.

- **Application of Nondiscrimination Requirement to Foreign Schools.** Remove the requirement that a foreign educational institution must comply with the specific procedures for publicizing its nondiscrimination policy set forth in Revenue Procedure 75-50[6] (or provide an account of why it has not, which must then be

[4] *See* Treas. Reg. § 1.170A-9(f)(4)(v); Treas. Reg. § 1.509(a)-3(d)(1).
[5] *See* Treas. Reg. § 1.509(a)-2(a)(2); Rev. Rul. 75-435, 1975-2 C.B. 215 (treating grants from foreign governments to a foreign charity as includable in public support without limitation).
[6] 1975-2 C.B. 587.

evaluated by the grantmaker). We agree that educational institutions should continue to attest that they operate according to a policy of nondiscrimination, but believe it is unreasonable to expect foreign organizations that may have different national histories regarding racial discrimination to know about and comply with these U.S.-specific requirements.

- **Application of Section 501(r) to foreign hospitals.** Conform Revenue Procedure 92-94 to current law, which makes clear that Section 501(r) does not apply to foreign hospitals.[7]

- **Electronic Data Collection.** To enable electronic collection of equivalency information, clarify that a physically signed affidavit is not essential.

- **Use of third-party materials.** Clarify that grantmakers may rely on translations and public information about foreign laws from other sources besides the foreign organization under review, as well as on nonprofit-provided affidavits that the grantmaker does not receive directly from the foreign nonprofit organization.

Request for Updated Guidance under the U.S.–Mexico Income Tax Convention

Under Article 22 of the U.S.–Mexico Income Tax Convention (the "Treaty"), and Article 17 of the Protocol to that convention, the U.S. and Mexico have agreed that certain Mexican charities meeting standards "essentially equivalent" to those applicable to U.S. public charities (originally those described in Article 70–B of the Mexican Income Tax Law) would be treated as public charities for purposes of grants from U.S. public charities and private foundations. Such Mexican charities are also exempt from U.S. income taxes to the same extent as their U.S. counterparts, and charitable contributions to such Mexican charities are eligible for U.S. income tax deductions (subject to some limitations).

In Information Letter 2003-158 (Sept. 30, 2003), the IRS confirmed that U.S. grantmakers could rely on the Mexican Ministry of Finance and Public Credit's determination of Article 70–B status, set forth either in a letter from that agency providing special authorization under Article 70–B, or reflected in the current official list of Mexican charities published in the Mexican *Official Gazette* (*el diario official de la Federacion*). That guidance, however, is now out of date. Mexico has renumbered its income tax provisions a few times since ratification of the Treaty; for more than a decade, former Article 70–B has been found in Article 97. However, it was moved to Article 82 of a Mexican Income Tax Law that took effect January 1, 2014, which also contains provisions governing other types of charities. There have been some minor substantive changes made to Article 97 at various points over the past few years, and the new law includes additional changes (particularly regarding activities influencing legislation), although the core requirements (to be organized and operated exclusively for exempt purposes, to avoid private inurement, to have a valid dissolution clause, etc.) are still in place.

[7] *See* 77 Fed. Reg. 38150. *See also* Prop. Reg. §§ 1.501(r)-1(b)(15).

For the past several years, the most current version of the list of Mexican charities eligible to receive tax-deductible contributions has been available online at http://www.sat.gob.mx/terceros_autorizados/donatarias_donaciones/Paginas/directorio_donatarias.aspx. Those organizations qualifying for treaty benefits have been specially designated as type "L" organizations; the list expressly states that such organizations meet not only the requirements of former Article 97, but also the provisions previously in Article 70–B (which carried over into Article 97 when it was renumbered). We do not yet know how these listings, and the ability to rely on them, have been affected by the 2014 statutory changes.

Until 2014, private foundations and other donors could generally rely on the Mexican authorities' determination that an organization qualified under Article 97 and former Article 70–B to treat it as a public charity. However, the recent changes will inhibit many grantmakers from relying on the Mexican Treaty until Treasury and the IRS provide clear guidance about how it applies to the new Mexican Income Tax Law. We would specifically request that Treasury, consulting with the Mexican government as necessary, do the following:

- Identify the class of Mexican charities that will be treated as "essentially equivalent" to Sections 509(a)(1) and 509(a)(2) public charities under the new Mexican Income Tax Law in effect as of January 1, 2014, and provide updated information as to the documentation upon which U.S. grantmakers can rely for purposes of determining status of a Mexican organization under the Treaty.

- Confirm that under Article 2(4) of the Treaty, Section 4966's excise tax is a subsequently added excise tax "identical or substantially similar" to Section 4945, and that donor advised funds can therefore rely on the Treaty to the same extent as private foundations and other public charities.

- In the interim, provide transition relief allowing U.S. grantmakers to continue to rely on determination letters confirming status under former Article 97, at least with respect to grants committed before the change in Mexican law.

Some of this guidance could be provided as part of an update of Revenue Procedure 92-94, or it could be separated out, given its potential applicability to individual donors or to determining the tax-exempt status of qualifying Mexican organizations from U.S. income taxes.

Recently, the Council has also become aware of issues arising from Mexico's anti-money laundering and anti-terrorist financing rules that are causing considerable confusion among U.S. grantmakers and are having an impact on the grantmaking authorized by the Treaty. Public statements by officials from the Treasury financial crimes enforcement agency, FinCEN, indicate that there has been coordination between Mexico and FinCEN on various enforcement matters.[8] Many of the concerns of our members arise from confusion regarding the nature and extent of information that U.S. grantmakers must provide to the Unidad de Inteligencia Financiera

[8] *See, e.g.* FinCEN and Mexican Counterpart Shine Spotlight on Cross-Border Cash Couriers, FinCEN Press Release, August 1, 2014, and Jennifer Shasky Calvery, Director, Financial Crimes Enforcement Network, remarks to the *Mexican Bankers Association AML/CFT Seminar,* October 3, 2014.

("UIF"), particularly personal identifying information. Given the impact of the rules on Treaty-authorized grantmaking, we ask that Treasury consider raising the need for greater clarity in the reporting obligation when it discusses the Treaty issues with Mexico noted above.

Request for Expansion of FATCA Exemption to Include Charitable Grants

July 1, 2014 marked the start of implementation of many provisions of the Foreign Account Tax Compliance Act of 2010 (FATCA),[9] a major legislative effort to force additional reporting by offshore financial institutions and other foreign entities about the extent to which investment income they receive is attributable to U.S. persons, thus making it more difficult for U.S. persons to evade tax by hiding assets in offshore accounts.

In many cases, the regime now requires U.S. institutions paying "withholdable payments" to foreign persons to have those foreign persons fill out a certificate selecting their appropriate status under FATCA's rules, choosing from a dizzying array of options such as "Active NFFE," "Excepted Nonfinancial Group Entity," "Owner-Documented FFI," and "Entity Wholly Owned by Exempt Beneficial Owners," and usually then being required to make detailed certifications confirming that it meets the conditions for that status.[10] Foreign grantees might be able to qualify as "501(c) Organizations," but that requires either an IRS letter or an opinion of counsel confirming that status, or certification as a "Nonprofit Organization" confirming that the organization is tax-exempt, restricted to charitable purposes, and meets various other requirements under local law.[11] Depending on the recipient's classification, withholding or reporting on the payment may be required, or more information about the ownership of the entity might have to be disclosed.[12]

FATCA is aimed at requiring increased disclosure primarily in the context of financial institutions and other entities making payments of investment income or similar financial payments. The regulations under FATCA have provided clear exemptions from the definition of "withholdable payment" for certain nonfinancial payments, including the following:

- Compensation for services;
- Payments for the use of property;
- Office and equipment leases;
- Software licenses;
- Transportation and freight payments;
- Gambling winnings; and
- Awards, prizes, and scholarships.[13]

Thus, those making such payments are not subject to the extra complications of the FATCA regime.

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[9] Pub. L. No. 111–147, 124 Stat. 97 (2010).
[10] *See* IRS Form W-8BEN-E (revised Feb. 2014), *available at* http://www.irs.gov/pub/irs-pdf/fw8bene.pdf
[11] *See id.*
[12] *See* I.R.C. §§ 1471, 1472; Treas. Reg. § 1.1471-1, -1T.
[13] Treas. Reg. § 1.1473-1(a)(4)(iii).

We believe that grants from Section 501(c) organizations, whether to individuals or to entities, are of a similar nature to prizes, scholarships, and awards, or in some cases to payments of compensation (in the case of grants for the accomplishment of a specific project). If these payments are excluded from the FATCA regime, grants from U.S. tax-exempt organizations should also be excluded. Like these other payments, a grant is simply not a kind of income likely to be earned by a foreign account holding assets hidden offshore by private U.S. taxpayers. It is therefore not a financial industry transaction of the sort at which FATCA was aimed, and deserves to be classified with them as a "nonfinancial payment."

Relief is especially warranted because U.S. grantmakers and foreign grantees may be financially unsophisticated nonprofit organizations ill-equipped to deal with the complexities of the new FATCA regime. Forcing them to put in place the document collection and reporting systems to comply with FATCA potentially adds a whole new level of bureaucracy to cross-border grantmaking beyond equivalency determination or expenditure responsibility, without meaningfully impacting disclosure of private U.S. taxpayers hiding income-producing assets in foreign accounts.[14] Furthermore, we see little justification for a rule that would make a foundation's service contract payments to foreign vendors, but not grants to foreign grantees for charitable work, exempt from the FATCA regime. Such an asymmetry would create perverse incentives for U.S. charities to structure their payments to foreign persons for charitable work as contracts for services rather than as grants.

Accordingly, we recommend that Treasury adjust FATCA to make the following changes:

- Amend Treasury Regulation Section 1.1473-1(a)(4) or the corresponding temporary and proposed regulations to remove grants from Section 501(c) organizations from the definition of "withholdable payment."

- Confirm that grantmakers may use a version of the Form W-8BEN that does not require determination of Chapter 4 (i.e., FATCA) status for grant payments and similar payments excluded from the definition of withholdable payment.

[14] We recognize that many grants are already excluded from the definition of "withholdable payment" because they are not U.S.-source taxable income to the recipient, either because they are not considered U.S.-source income under Treasury Regulation § 1.863-1(d) or because they are excludable from income as gifts or under other provisions of the Code. *See, e.g.*, Priv. Ltr. Rul. 200529004 (July 22, 2005) (holding that a charitable grant to a foreign nonprofit entity was not income because it was a gift under section 102). However, that only strengthens the argument for not requiring FATCA compliance in the remaining cases, so that grantmakers do not have to build out elaborate grantee processing systems to deal with those grants that for some reason fail to qualify for these exceptions. For instance, it is not infrequent for a large grant for a project in a foreign country to include some funding for a small amount of activity in the United States, thus making part of the grant U.S.-source and subject to FATCA withholding unless another exception applies. This requires the grantmaker to parse through the complicated rules for collecting information and reporting it under FATCA because of a relatively minor portion of a much larger grant.

Request for Assistance with Bank Derisking for Humanitarian Relief Efforts

The Council on Foundations requests the Treasury prioritize how significant numbers of legitimate charitable funds are delayed by federal government and banking due diligence. Grantmaking to civil society organizations is relied on by intergovernmental organizations and the U.S. government to deliver humanitarian aid. Yet, fund transfers can take over six months and in that time hospitals cannot purchase fuel to run generators, programs that provide stability to communities are cancelled or are unreliable due to stops and starts in services. This erodes community trust in civil society organizations.

Grantmakers recognize their crossborder grantmaking may be high risk and low profit for the banks they work with. Yet, absent a workable solution with cooperative banks to make timely donations into conflict and famine zones, grantmakers are exploring options. Grantmakers have collectively invested in equivalency determination and vetting tools such as NGOSource. Grantmakers appreciate efforts to improve the "know your customer" process and recognize the value of financial utilities like Clarient as part of The Depository Trust and Clearing Corporation, yet we understand it is under-utilized in the financial system.

While grantmakers may be weary of alternative systems, there is a risk analysis to be done. Some grantmakers have tried to make many small grants to see if the grant will move more quickly. Others make large grants when they can get the grant through the banking system. In dire situations, they explore cash carry or cash wallas. Many of these methods result in grantees stockpiling cash on hand because they cannot rely on regular transactions to occur. Grantees are then at greater risk for armed robbery and physical harm. This pillaging of resources by terrorist organizations is the exact thing crossborder grantmaking regulations attempt to prevent on the front end of the transaction yet the strict system creates the problem on the back end of the transaction. Grantmakers can use the blockchain to remove operational costs and third party barriers in grantmaking. This is useful in extreme humanitarian circumstances during times of conflict and famine.

Cryptocurrencies and blockchain technology has benefits and challenges. The blockchain is a digital ledger in which transactions made in cryptocurrency (like Bitcoin) are recorded and chronologically and publicly. A blockchain grant in the form of cryptocurrency is part of a decentralized distributed public ledger system not owned by a single party or central bank. Grantmaking in this manner may be more accountable than alternatives such as cash carry to conflict zones. At the same time the blockchain makes proprietary information publicly available outside of the organizations in real times while donors to organizations may be difficult to trace.

The Council on Foundations hopes to be a resource to the Treasury department as they continue to review regulations for cross border grantmaking.

Request for General License for 2017 Famine

This year, more than 20 million lives are at risk due to famines in Somalia, South Sudan, Nigeria, and Yemen. This is expected to be one of the worst famines on record. As nonprofit

organizations prepare to respond to the crisis, it would be extremely helpful if Treasury would issue a general license to enable nonprofits to engage in humanitarian relief efforts in the countries affected by famine.

There is precedent for the sort of general license that we are seeking in the Syria General License No. 11A, issue by the Office of Foreign Assets Control pursuant to Executive Order 13582 on August 17, 2011. That license provided authorized nongovernmental organizations to export or reexport services to Syria that would otherwise be prohibited in support of certain not-for-profit activities, including:

> (1) Activities to support humanitarian projects to meet basic human needs, including, but not limited to, drought relief, assistance to refugees, internally displaced persons, and conflict victims, food and medicine distribution, and the provision of health services;
>
> (2) Activities to support democracy building, including, but not limited to rule of law, citizen participation, government accountability, and civil society development projects;
>
> (3) Activities to support education, including, but not limited to, combating illiteracy, increasing access to education, and assisting education reform projects;
>
> (4) Activities to support non-commercial development projects, including, but not limited to, preventing infectious disease and promoting maternal/child health, sustainable agriculture, and clean water assistance; and
>
> (5) Activities to support the preservation and protection of cultural heritage sites, including, but not limited to, museums, historic buildings, and archaeological sites.

The General License also authorized U.S. depository institutions, U.S. registered brokers or dealers in securities, and U.S. registered money transmitters to process transfers of funds on behalf of U.S. or third-country non-governmental organizations to or from Syria in support of these activities, unless the transfer is through the government or certain persons blocked by Executive Orders.

We believe a new general license aimed at the 2017 famine would be a significant step toward mitigating the disaster, and would help our members save thousands of lives.

Conclusion

In sum, and in accordance with the above, we strongly urge the Department of Treasury to act swiftly to update Revenue Procedure 92-94. We also ask that it update its guidance regarding application of the Mexican Treaty, take the steps outlined above to keep FATCA from imposing significant additional regulatory burdens on cross-border philanthropy, assist with bank derisking efforts for humanitarian relief, and issue a general license to enable nonprofit organizations to respond to the famines in South Sudan, Somalia, Yemen, and northeast Nigeria. Each of these

items deserves a place on the Treasury Department's 2017-2018 Priority Guidance Plan. Updated guidance will be of significant assistance to the philanthropic sector and also to the IRS, which has expressed concerns to the Government Accountability Office regarding the "overseas activities" of some tax-exempt organizations.[15]

Thank you for your attention to this matter. We would welcome the opportunity to discuss any of these matters with the IRS or with the Department of Treasury if it would be helpful. In particular, the Council offers its support for convening more informal discussions of the compliance issues faced by U.S. grantmakers regarding grants to charities in Mexico. It is possible that an exchange that included representatives of both governments and the philanthropic sector in both countries could point the way to clearer, more effective and more efficient guidance on the important philanthropic relationship between the two nations.

Sincerely,

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[15] *See* United States Government Accountability Office Report to the Ranking Member, Committee on Homeland Security and Governmental Affairs, U. S, Senate, *Tax-Exempt Organizations, Better Compliance Indicators and Data, and More Collaboration with State Regulators Would Strengthen Oversight of Charitable Organizations,* December 2014, GAO-15-164.