



U.S. Federal Tax Compliance Guidelines for Grants by 501(c)(3) Public Charities to Foreign Organizations and Individuals

If a church, school, or other 501(c)(3) public charity is engaging in foreign activities, an initial determination should be made as to whether those activities constitute grantmaking activities or direct charitable activities. The U.S. public charity should consult with its legal counsel regarding the determination of whether a transaction with a foreign organization or individual constitutes a grant, as opposed to a vendor payment by the U.S. public charity for services rendered on behalf of the U.S. public charity. If it is determined that the U.S. public charity is engaging in direct charitable activities in the foreign jurisdiction, the U.S. public charity should address with appropriate professional counsel in that jurisdiction the legal and tax ramifications of operating in the foreign jurisdiction.

U.S. federal tax law is not specific with respect to documentation requirements for grants made by churches, schools, and other 501(c)(3) public charities to foreign organizations and individuals. 501(c)(3) public charities are, however, subject to general requirements in federal tax law that they maintain adequate records to demonstrate that their activities and expenditures are in furtherance of their tax-exempt purposes. Specific rules do exist in federal tax law for 501(c)(3) private foundations. The requirements for private foundations include an “expenditure responsibility” rule which contains specific documentation requirements to support grants to foreign organizations and individuals. While not clearly required by law, the IRS has effectively taken the position in examinations that public charities should follow the expenditure responsibility requirements applicable to private foundations when making foreign grants.

Accordingly, to prepare for the possibility of an IRS examination and to improve the likelihood of being found in compliance with federal tax law, we recommend that 501(c)(3) public charities apply, subject to and under the advice of their legal counsel, the following practices (which are based on the expenditure responsibility requirements for private foundations) with respect to grants made to foreign organizations and individuals:

Pre-grant inquiry

The U.S. public charity should perform a pre-grant analysis of the legitimacy of the foreign organization/individual receiving the grant. The inquiry should give the U.S. public charity reasonable assurance that the foreign organization/individual will use the grant for the proper purposes. The inquiry should address such matters as the identity, past history, and experience of the individual grantee (or the foreign organization and its principals/managers), and include a review of any other information the U.S. public charity has concerning management, activities, and practices of the foreign organization/individual. The U.S. public charity should also verify that the individual grantee (or the foreign organization and its principals/managers) are not listed on the government’s anti-terrorism watch lists, which may be found at <https://www.state.gov/terrorist-designations-and-state-sponsors-of-terrorism/#state> and www.treas.gov/offices/enforcement/ofac/sdn/.

The U.S. public charity should retain proper documentation of its pre-grant inquiry and the results.

Grant agreement

Grants made by a U.S. public charity should be made subject to a written agreement drafted under the advice of legal counsel and signed by the foreign individual, or an appropriate officer, director, or trustee of the foreign grantee organization. The agreement should include the following elements:

- The amount(s) to be granted.
- The specific purpose(s) for which the grant funds will be used and where the grant activities are to be conducted.

- A covenant by the grant recipient that it will not use the funds for lobbying, attempting to influence the outcome of any public election or voter registration drive, or any activity other than those specifically permitted by the grant agreement.
- A covenant by the grant recipient that it will repay any portion of the grant not used for purposes specified in the agreement.
- A covenant by the grant recipient that it will submit full and complete reports regularly (at least annually) concerning the manner in which the funds were spent and the progress made in accomplishing the purposes of the grant.
- A covenant by the grant recipient that it will maintain records of funds received and expended and will make its books and records available to the U.S. public charity.
- A requirement that the grant recipient use the funds for activities conducted entirely outside the U.S. and that none of the funds should be used for travel to the U.S. [Note that if the granting organization wishes to permit any portion of the funds to be used for travel to the United States, that aspect of the proposed arrangement should be carefully and specifically reviewed by special tax counsel to ensure compliance with applicable law.]
- A statement that the grantor organization has no moral or legal duty to provide the grant funds.
- A statement that the grant recipient assumes full responsibility for the appropriate tax compliance filings in the relevant jurisdiction(s) in connection with the receipt of the granted funds.
- A statement that the grant agreement shall not be construed as establishing an employment or agency relationship between the grantor organization and the recipient.

Periodic reports from the foreign grantee

The U.S. public charity should obtain reports at least annually from the grant recipient for the year in which the grant was made and for all subsequent years in which the grant funds are expended by the grant recipient. The reports should be furnished to the U.S. public charity within a reasonable time following the close of the grantee's fiscal year. The reports should be signed by the foreign individual (or an appropriate officer, director, or trustee of the foreign grantee organization), and should contain the following elements:

- Name and address of the foreign grantee organization/individual.
- Date, amount(s), and purpose(s) of the grant.
- Amounts expended by the foreign grantee organization/individual to date, together with reasonably specific information about how the funds were spent. (General financial statements from the grantee should only be considered adequate for this purpose if the U.S. public charity can reasonably derive from those statements how the granted funds were actually spent.)
- An affidavit stating that no portion of the funds has been diverted from their intended purpose(s).

Field visits and inspection of books and records

The U.S. public charity should apply a risk-based approach to making periodic physical inspections of the activities of foreign grant recipients. When grant amounts are significant and it is otherwise feasible and appropriate, the U.S. public charity should make periodic field visits to the foreign grantee's locations to evaluate the progress made in accomplishing the purposes of the grant. The observations made in the field visits should be well documented. Additionally, a grant-making U.S. public charity should apply a risk-based approach to inspecting a grant recipient's books and records related to the use of grant funds. The amount of funds granted and the quality of accountability reporting by the grant recipient are significant factors that should affect the decision as to whether to inspect books and records. Inspection results should be well documented.

OTHER CONSIDERATIONS

The U.S. public charity organization should consult with legal counsel regarding any legal implications associated with the making of foreign grants, including (but not limited to) the specific terms of the grant agreement.

Treasury Department "Voluntary Best Practices"

In addressing the fact that some financing of terrorist activities has occurred through U.S. charities, the Treasury Department has issued a non-authoritative document entitled "[U.S. Department of the Treasury Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities.](#)" These voluntary guidelines have been revised twice since they were originally issued, and they cover a broad array of topics far beyond international grantmaking activities. The topics range from fundamental nonprofit governance practices to specific aspects of administering a foreign grant. Applying all of the specific practices described in that document would be logistically very challenging for most organizations, and doing so is not common in the nonprofit sector. Nevertheless, the guidelines do provide helpful information and guidance for consideration as part of a sound international grantmaking program for U.S. public charities.

This sample document is provided for general information purposes. It does not constitute professional advice. It is a generic document that is not specifically designed for your organization. We have provided it as a matter of professional courtesy for you to consider, together with your legal counsel, as you determine policies and/or provisions of your governing documents that are appropriate for your organization. In establishing your organization's policies or provisions of your governing documents, you should consider, together with your legal counsel, your unique operational, financial, and legal circumstances.