

## **International Activities of Domestic Charitable Organizations**

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MARY JO

Most of us have witnessed the ways U.S. charities mobilize to help victims of hurricanes, earthquakes and other natural disasters domestically and in other countries. And we see the ongoing work that they do around the world that funds and supports education, improved healthcare, human rights and raised living standards.

U.S. based organizations are major players in global philanthropy. They do their work in different ways. Some donate money directly to foreign organizations, foreign individuals, or foreign governments. Some give to other U.S. or multinational charities working abroad. Others choose to operate in foreign countries with their own infrastructure and staff.

In whatever manner an organization decides to operate, those decisions have implications under the tax law that can affect the organization's tax-exempt status, taxability of income and deductibility of contributions from donors.

I'm Mary Jo Salins

WARD

And I'm Ward Thomas. We work in the Rulings and Agreements area of the IRS Exempt Organizations Division. Exempt Organizations is the part of the IRS responsible for enforcing many of the rules we will talk about today.

We'll try to help you understand those rules, so the organizations you represent can pursue their international work in ways that protect their tax-exempt status.

This webinar will cover some of the federal tax rules concerning the overseas charitable operations of domestic 501(c)(3) charities. Topics we look at today include basic 501(c)(3) requirements in the context of foreign activities, charitable deduction considerations, rules for

grants and grant making for both public charities and private foundations, including expenditure responsibility and equivalency determinations for private foundations, Form 990 reporting of foreign activities, Foreign bank accounts and Reporting, also known as F-BAR, and where to go for more help.

Foreign charities can also qualify as tax-exempt organizations, but in this webinar, we are concentrating on domestic organizations. Some of what we say may also apply to foreign charities, or to domestic exempt organizations that are not 501(c)(3) but engage in foreign activities and grantmaking.

MARY JO

So the first question might be what is the difference between domestic and foreign organizations?

Well, the answer depends on the issue. Let's start with the general rules under the Internal Revenue Code. Exempt organizations are classified for tax purposes either as corporations or trusts and there are different tests for corporations and for trusts. A corporation or association is domestic if it is organized under the law of the United States, or of any state, or the District of Columbia, but not the U.S. territories. The actual citizenship of those who incorporate the organization doesn't matter, as long as it's organized under the proper laws.

A charitable trust is generally considered domestic if it is controlled by U.S. trustees and it is subject to the primary jurisdiction of a court within the United States.

When we talk about charitable deductions, the rules under section 170 of the Code use a somewhat different definition. One difference is that a charitable trust is considered domestic, and thus can receive deductible contributions, if it is organized in the United States. Another difference is that the United States includes U.S. territories for this purpose. The section 170 concept of domestic organization also applies to private foundations for purposes of the special private foundation rules.

So, what activities is a domestic charitable organization allowed to do abroad? Generally, everything it can do in the United States it can also do in another country as long as the activity is consistent with the organization's exempt purpose, and as long as it follows all the rules.

Like all 501(c)(3) organizations, those that have international interests must be organized and operated exclusively for exempt purposes, such as charitable, educational, religious, and

scientific. For our discussion today, we will refer to these purposes collectively as charitable purposes or exempt purposes.

Some typical examples of activities that domestic organizations undertake abroad are: financial support to local charitable programs in another country; delivery of emergency food and shelter; contributions of personal property such as computers, or medicine; and a wide range of direct services to the general public such as religious ministry and vocational training.

## WARD

Generally the same 501(c)(3) rules apply regardless of whether the activities are conducted in the United States or abroad.

For example, every 501(c)(3) organization must keep in mind that:

- Its net earnings may not benefit any private shareholder or individual and the organization is prohibited from benefitting private interests other than incidentally. These are called the prohibition against inurement and private benefit
- It must not devote a substantial part of its activities to attempting to influence legislation
- It must not participate or intervene in political campaigns for public office
- Its purpose and activities may not be illegal or violate public policy, and
- It must comply with IRS reporting and notice requirements

Let's briefly describe them one at a time, starting with private benefit and inurement, which is also covered on pages 2 and 3 of Publication 4221-PC.

An organization is not operated exclusively for exempt purposes if its activities benefit the private interests of any individual or organization more than incidentally. This is known as the prohibition on private benefit.

If an organization provides more than incidental private benefit, its exempt status can be revoked. This is true even if the private interests served are unrelated to the organization. These rules help ensure that the charity truly serves the public, domestically and internationally

The concept of inurement takes this notion further.

Inurement is a benefit or something useful or beneficial. Section 501(c)(3) of the Internal Revenue Code states that no part of an organization's net earnings may inure to the benefit of a private shareholder or individual.

This means that the organization may not allow its income or assets to benefit or be used to the advantage of insiders. An insider is a person who has a personal and private interest in the activities of the organization, such as a board member, officer, perhaps a major contributor.

Examples of prohibited inurement include: The payment of dividends, the payment of unreasonable compensation to insiders, and the transfer of property to insiders for less than fair market value.

This does not mean that directors, officers, and/or employees cannot be compensated for their services. They can be paid, but any compensation paid for services rendered must be reasonable.

Running afoul of either of these can lead to revocation of an organization's tax exempt status. However, the law provides something short of revoking tax-exempt status when that may be too harsh a punishment, or doesn't punish the persons who benefitted or who made the decision to provide the benefit. Such persons may be subject to a tax under section 4958 on excess benefits and must give back the excess benefit.

The key point to be made here is that these inurement and private benefit rules apply with equal force whether the organization's operations are in the United States or abroad.

There are many other details to the concepts of private benefit and inurement. You can explore them further, the details of this are in IRS Publication 4221-PC, "Compliance Guide for 501(c)(3) Public Charities." You can find even more information at the IRS website "Charities and Nonprofits" page at [www.irs.gov/eo](http://www.irs.gov/eo) and typing the terms Inurement or private benefit into the search box.

## MARY JO

Another basic law for 501(c)(3) organizations is that a charity must not devote a substantial part of its activities to attempting to influence legislation, otherwise known as lobbying.

Under the Internal Revenue Code, an organization lobbies by contacting legislators or employees of a legislative body to propose, support or oppose legislation, or to advocate the adoption or rejection of legislation. An organization may also engage in grassroots lobbying by urging its members or the public to lobby.

In addition to action by a legislature, lobbying also includes action by the public in a referendum, ballot initiative, constitutional amendment, or similar procedure. However, actions by executive, judicial, or administrative bodies are not legislation.

For these purposes, the term "legislation" includes foreign as well as domestic laws

The prohibition against lobbying is not absolute. The law does allow some lobbying. A 501(c)(3) organization will jeopardize its tax-exempt status if lobbying is a substantial part of its activities. And private foundations that spend money on lobbying are subject to an excise tax on those expenditures. The tax generally is so significant that it acts as a prohibition.

But sometimes this rule is not so easy to apply internationally. In certain countries, such as those ruled by authoritarian or theocratic regimes, it may be questionable whether the governing body

is a legislature, or if a legislative process as it's known in the United States even exists. Organizations that operate in such situations should familiarize themselves with applicable foreign laws and exercise caution in their activities

A 501(c)(3) organization is prohibited from directly or indirectly participating or intervening in a political campaign of a candidate for public office— foreign or domestic. Unlike lobbying, this prohibition is absolute. The IRS treats overseas and domestic activity alike for purposes of granting or revoking tax-exempt status. Contributions to political campaign funds, or public statements made on behalf of the organization for or against any candidate for public office, are clear violations. A 501(c)(3) organization that makes a contribution to a foreign candidate's campaign for president or that supports candidates for a foreign parliament would be breaking the rules.

Some activities fall outside the restrictions. For example, in a country ruled by a dictatorship, an organization's criticism of the regime in the course of advocating for democracy, the rule of law, or human rights would not ordinarily be regarded as intervention in a political campaign, though all the facts and circumstances must be considered. Nonpartisan voter education activities (including the presentation of public forums and publication of voter education guides) are permissible.

## WARD

Another fundamental 501(c)(3) principle is that a charity cannot operate for a purpose that is illegal or contrary to public policy. For example, because of the strong U.S. policy against racial discrimination in schools, a 501(c)(3) organization's operation of a foreign school must meet the non-discrimination requirements of Rev. Proc. 75-50. However, if a foreign school can demonstrate that collecting the information would be illegal under foreign law or impractical under the circumstances, the IRS may waive some of the required reporting.

Charities may conduct direct charitable programs abroad, through the use of employees, volunteers, or other agents. But to accomplish charitable purposes abroad, more commonly they make grants to other organizations or individuals abroad.

Charities generally have a duty to exercise reasonable care to ensure that their assets are used for charitable purposes. This is the exercise of proper control and discretion. A charity can demonstrate control and discretion in its foreign grantmaking through:

- a proper vetting of the foreign grantee, such as written application from the grantee and background checks
- an agreement with the foreign grantee setting forth the purpose of the grant, and
- oversight of the grant to ensure the grant is used as intended.

Proper documentation may include periodic reports from the grantee, accountings of expenses, copies of receipts, reports of on-site visits by agents of the grantor, and photos and videos showing the charitable program. The organization should review the reports and take corrective action in appropriate circumstances.

A charity's 501(c)(3) status can be revoked if the charity makes grants to foreign organizations or individuals and it cannot demonstrate that the grants were actually used for exempt purposes.

## MARY JO

Charitable donations can be the life blood of charitable organizations. One of the more important considerations for people making donations to charities that operate abroad is whether contributions to them are deductible, just as they would be for an organization that uses the money within the United States.

The law governing charitable deductions usually concentrates on where the charitable organization is created, and not where the contribution is used, as we discussed earlier in defining a domestic organization. Donations by individuals to domestic charitable organizations generally are deductible even if the contributions are entirely used abroad, subject to what are called conduit and earmarking restrictions, which we will discuss. An exception applies to a corporation that makes a contribution to a charitable trust. Those funds must be used within the United States in order for the contribution to be deductible.

Except for certain treaty exceptions which are beyond the scope of this discussion, contributions given directly to foreign organizations are not deductible. A foreign organization cannot sidestep that prohibition by using a domestic organization as an agent or conduit. Federal law requires that a qualified, domestic charitable organization have full control and discretion over the use of the funds.

Contributors may not earmark funds for the use or benefit of any specific organization or individual. But they can designate their contributions to go to a specific purpose such as earthquake relief or hurricane relief. An organization may also accept a non-binding recommendation or advice from donors.

Here are a few examples of organizations that are considered conduits

1. A foreign organization forms a domestic charity that conducts fundraising within the United States. After paying administrative expenses, the domestic organization sends the balance to the foreign organization.
2. People in the United States form a charitable organization within the U.S. The organization's charter says that it will receive contributions and send them to the foreign organization.
3. A foreign organization enters into an agreement with a domestic organization that says the domestic organizations will conduct a fund raising campaign on behalf of the foreign organization. When conducting the campaign, the domestic organization tells prospective contributors that the funds raised will go to the foreign organization.

## WARD

While public charities and private foundations can both make grants, private foundations have tighter restrictions on the kinds of grants they can make, criteria for grants and recordkeeping and reporting.

- Both public charities and private foundations may make foreign grants to
- Individuals for exempt purposes
- Foreign governments for charitable purposes
- Foreign organizations qualified under section 501(c)(3)
- U.S. public charities to directly support a program abroad
- U.S. public charity intermediaries – such as.,
- a “Friends Of” organization
- a “donor-advised” fund, and
- Non-501(c)(3) organizations for exempt purposes

We’ll cover these in a little more detail to help you understand them.

## MARY JO

A 501(c)(3) organization may make grants to individuals, as long as the grants are made on a charitable basis and they further the organization’s exempt purposes. A common example of this is organizations that provide scholarships to students in foreign countries, or help foreign students come to study in the United States. A public charity shows that grants to individuals are appropriate by keeping records and case histories that document the following:

- The names and addresses of the recipients
- The amounts and purposes of the grants
- The manner in which the recipients are selected, and
- Any relationships between the recipients and any members, contributors or officials of the organization

When private foundations make grants, it gets a little more complex. There are special rules for grants that private foundations make for travel, study and similar purposes. The IRS must approve the organization’s selection procedures before the organization makes these types of grants. The foundation may request IRS approval on Form 1023, or by a separate request for a determination letter.

The foundation must develop objective and non-discriminatory selection procedures that meet basic requirements:

- The purposes and operations of the grant program must be consistent with the foundation’s exempt purposes

- The pool of potential recipients must generally constitute a charitable class (unless selection of recipients is based on exceptional qualifications, such as expertise in a particular area)
- The selection criteria must be related to the purposes of the grant
- There must be no conflicts of interest, and
- There must be effective monitoring, supervision and recordkeeping of the grants

A private foundation does not need advance approval from the IRS for other payments to individuals such as distributions to relieve financial need, unless the grant is for travel, study, or similar purposes. Also, grants do not include salaries or compensation to employees, or payments for consulting services.

## WARD

U.S. charitable organizations can make grants to support the charitable programs of foreign governments. The grants can't be made for the general support of a foreign government, but can be made to a unit of a foreign government to support a specified charitable purpose. OFAC sanctions may prohibit grants to certain foreign governments, however.

Examples are disaster relief programs or operations of schools, hospitals or orphanages.

Records are important here. The documentation should demonstrate that that the recipient is a foreign government, and the organization should keep a copy of the grant letter that specifies the charitable purpose of the grant.

U.S. charities may make grants to foreign charities that have been recognized by the IRS as exempt under section 501(c)(3). But again it's important that the domestic charity maintain discretion and control over the use of the grant funds to ensure deductibility of contributions from individual donors.

Private foundations have a requirement under section 4942 of the Internal Revenue Code to annually distribute a certain part of their funds for charitable purposes. The foundations should be sure that the grants they make are qualifying distributions. To qualify, the foreign organization receiving the grant must have an IRS ruling or determination letter classifying it as a public charity or operating foundation. Or the foundation can decide to make an equivalency determination, or exercise expenditure responsibility, which we will explain a little later

The simplest and most popular way to support charitable efforts abroad is to make a grant or contribution directly to a U.S.-based 501(c)(3) public charity that has an established international program Many U.S. public charities operate abroad through foreign branch offices and controlled subsidiaries.

Private foundations, by making grants to a recognized U.S. public charity, can ensure that a grant furthers charitable purposes, counts toward the foundation's distribution requirement, and will not result in a taxable expenditure.

Public charities that support efforts abroad can function as intermediaries, usually focusing on a particular area of philanthropy or a particular geographical area. These organizations raise funds in the United States, screen potential recipients and re-grant the funds overseas. The most common types of intermediaries are Friends of organizations, and donor advised funds.

## MARYJO

"Friends of" organizations are usually organized to raise funds primarily to support a specific foreign charity. Often they have the name of the organization in their title, such as "Friends of the Smith School." Structured properly, "friends of" organizations allow donors essentially to support the foreign charity by making tax-deductible contributions to the domestic 501(c)(3) "friends of" organization, whereas a contribution directly to the foreign charity would not be deductible. "Friends of" organizations provide support ranging from grants for programs, equipment, and materials, to scholarships and fellowships. They can be private foundations, but most are public charities.

Friends of organizations must exercise discretion and control over the funds they raise. Some of the factors the IRS considers when looking at a Friends of organization are:

- The charter provides that the board has discretion to allocate contributions received to any charity.
- The bylaws provide that the board will review all requests for funds, require that the requests specify the proposed use of the funds, and require a periodic accounting of funds granted.
- The bylaws allow the organization to solicit funds for a specific project or purpose approved by the organization, but retain the organization's right to withdraw approval of the grant and use the funds for other purposes, and
- The organization makes these policies known to donors upon request, and refuses to accept contributions earmarked so that they must go to the foreign organization.

Public charities can offer what are called donor-advised funds to individuals and corporations.

A donor-advised fund is a separately identified fund or account that a charity, called the sponsoring organization, maintains and operates. Each of these accounts is composed of contributions made by individual donors. Once the donor makes the contribution, the sponsoring organization has legal control over it, but the donor has advisory privileges regarding the distribution of funds and the investment of assets in the account.

The tax law limits the kind of grants donor-advised funds are allowed to make. The law now prevents donor-advised funds from making grants to individuals or making any grants for non-

charitable purposes. The law also requires the sponsoring organization to exercise expenditure responsibility with respect to grant to organizations, except for grants to most types of public charities. Or, instead of expenditure responsibility, the sponsoring organization can make an equivalency determination that a foreign grantee organization is a public charity. Regulations regarding donor advised funds have not yet been published.

## WARD

A supporting organization under section 509(a)(3) is a public charity that typically provides financial support to one or more other public charities and has a close structural relationship with the other public charities, whether Type I, II, or III. A Type III supporting organization cannot support a supported organization that is not organized in the U.S.

A 501(c)(3) charity is allowed to distribute funds to foreign organizations that are not charities and not recognized as tax-exempt under U.S. law. The U.S. charity must be sure that the funds are used for specific projects that further its own tax-exempt purposes. It must keep appropriate records. And it must show it has appropriate discretion and control over the funds. . The U.S. charity can demonstrate proper discretion and control with the following procedures:

- The organization can make an independent decision about whether it will provide funds to a foreign organization, and is not required to abide by the donor's direction;
- The organization conducts a pre-grant inquiry to be reasonably sure that the grant will be used for exempt purposes;
- The organization makes a written agreement with the recipient regarding the use of the funds; and
- The organization obtains reports that the funds were used for approved exempt purposes

As we mentioned earlier, the law requires private foundations to distribute a certain amount of their income each year to avoid excise taxes. If the foundation wants to make sure that its grants to foreign non-exempt organizations will be treated as qualifying charitable distributions and not as taxable expenditures, the foundation can do one of two things. It can either make a good faith determination that the foreign organization is the equivalent of a public charity, known as an equivalency determination, or it can exercise expenditure responsibility. Sponsoring organizations of donor advised funds also must make an equivalency determination or exercise expenditure responsibility.

Equivalency determination and expenditure responsibility are important concepts for private foundations to understand.

## MARY JO

Let's talk about them in more detail and how a foundation can choose the method that best suits a particular situation.

A foundation may want to use an equivalency determination if

- It expects to have a long-term relationship with a foreign organization
- The grant recipient can provide governing documents and other necessary data
- The organization receiving the grant is a church, school, hospital or medical research organization that is not required to submit financial data to show it is the equivalent of a public charity
- The grant-maker anticipates making general support grants rather than grants for specific projects, or
- The grant recipient intends to re-grant the funds to accomplish its own exempt purposes

Completing the equivalency determination takes two steps

- The grant-making foundation must make a reasonable judgment that the organization receiving the grant meets the description of a charity in section 501(c)(3). And,
- The grant-maker must make a good faith determination that the recipient is a public charity or a certain tax-favored type of private foundation known as an exempt operating foundation. The good faith determination must be based on an affidavit from the recipient or an opinion of counsel of either the grant-maker or the recipient. The affidavit or opinion of counsel must give enough facts about the recipient's operations and support to allow the IRS to determine that the recipient would likely qualify as a public charity or exempt operating foundation.

The foundation should have English translations of the following documents

- Founding documents of the organization
- Detailed description of the purposes of the organization and its past and proposed activities
- Dissolution provisions, either contained in the applicable law or in the founding documents
- Legal or founding document restrictions on private benefit, non-charitable activities, lobbying, and participation in political campaigns, and
- Detailed financial records (excluding churches, schools, hospitals, and medical research organizations)

It is also customary for the foundation to review the organization's annual report and strategic plan, any documentation of exempt status under the laws of the foreign organization's jurisdiction, and its website.

WARD

Revenue Procedure 92-94 provides an optional safe harbor for making an equivalency determination. The grant-maker generally may rely on a currently qualified affidavit that states

that the recipient is the equivalent of a public charity or exempt operating foundation. An affidavit is considered currently qualified if it contains up-to-date information.

Generally, an affidavit must be written in English, and an English translation must be provided for any supporting documents. The affidavit must be signed by a principal officer of the recipient organization. The grant-maker must keep the original or a photocopy of the affidavit and make it available to the IRS upon request.

The affidavit should contain a declaration by the principal officer that the affidavit is made to assist grant-making foundations in the United States in determining whether the foreign organization is the equivalent of a public charity or an exempt operating foundation. The affidavit should include copies of the organization's governing documents, state when the organization was organized, and describe the organization's purposes and past and planned activities. The affidavit should also state the following things:

- that the applicable laws and customs do not permit the organization's assets or income to benefit a private person
- that the organization has no shareholders or members with a proprietary interest in the organization's income or assets
- that upon dissolution or liquidation, under law or custom or governing documents, all of the organization's assets will be dedicated to charitable purposes
- that the applicable laws and customs do not permit the organization to engage in substantial non-charitable activities or lobbying
- that the applicable laws and customs do not permit the organization to intervene in any political campaign, and
- whether the organization is controlled by or operated in connection with any other organization

If the foreign charity would have to meet a public support test, the affidavit must include appropriate schedules showing certain updated financial information.

If the foreign entity's public charity status does not depend on financial support, it must provide updates of any changes in activities or an attested statement to the effect that there have been no changes.

## MARY JO

A grant-maker might prefer to exercise expenditure responsibility if:

- It plans to make a short-term, one-time grant
- The grant recipient has difficulty providing financial data for past years or obtaining a certified copy of governing documents, or
- The grant-maker prefers more extensive reporting requirements

A private foundation grant maker is required to use expenditure responsibility when a grant is made to any organization other than a public charity that has a 501(c)(3) determination letter or an equivalency determination by the foundation. A foreign government is treated as an IRS-recognized public charity for this purpose, but certain 509(a)(3) supporting organizations are not.

A grant for this purpose includes a program-related investment, which is an investment made for charitable purposes rather than to make money, such as a micro-loan to help a low-income person start a business.

When exercising expenditure responsibility an organization should make a pre-grant inquiry. The inquiry should gather information about the potential recipient to ensure that it will use the funds for their intended purpose, and that it can administer the grant appropriately.

To the extent possible, the grant-maker should try to get organizational documents, descriptions of the organization's activities and mission, information on key organization officials and key employees, and annual financial statements and applicable financial accounting policies. An organization should also seek information about a potential recipient's experience in administering grants.

Where it's possible or helpful the grant-maker also might wish to conduct an on-site visit.

## WARD

Once the domestic organization decides to make the grant, it should obtain a written grant agreement signed by the grantee that

- Specifies the grant's purpose
- Prohibits the use of grant funds for lobbying, political activity and other non-charitable purposes

The signed grant agreement also requires the grantee to

- Repay any grant funds not expended for the purposes of the grant
- Maintain the funds in a separate account or separate fund for charitable purposes.
- Maintain records of receipts and expenditures for at least four years after the funds have been used and to make these records available to the grant-maker
- Provide annual reports, and
- Make a written agreement with these terms for any re-grant of funds

## MARY JO

The granting organization should require periodic reports from the grant recipient that provide a detailed account of how the funds were used. The report should compare the actual use of the funds to the budget. It should include a narrative description of how the recipient is achieving the grant's purposes, a statement indicating whether the recipient is in compliance with the terms and conditions of the grant and be signed by an authorized officer of the recipient. The final report should provide the same information for the entire period of the grant.

Private foundations must report to the IRS annually on Form 990-PF every expenditure responsibility grant made, paid, or for which a report is outstanding during the year.

The report should include:

- Name and address of the grant recipient

- Date, amount and purpose of the grant
- Amounts expended by the recipient based on the most recent report
- Dates of the recipient's reports
- Whether there has been any diversion of funds, and
- Dates and results of verification and follow-up on the recipient's reports

If for any reason there is a diversion of grant funds for improper purposes, or for purposes inconsistent with the grant agreement, a charitable organization must take corrective action

Specifically, the grant-maker is required to take all reasonable and appropriate steps to recover the grant funds. It must also ensure the restoration of the diverted funds and dedication of remaining funds for the purposes specified in the grant agreement. Further, it must withhold payments to the grant recipient until it receives assurances that further diversions will not occur. Finally, it must be assured that the recipient will take extraordinary precautions to prevent further use of grant funds for improper purposes.

If a grant recipient fails to provide an adequate report, the grantor must make a reasonable effort to obtain the information and withhold future payments until the information is received.

#### WARD

U.S. Charities in conducting their foreign activities and grantmaking should be mindful of the sanctions programs of the Treasury Department's Office of Foreign Assets Control, known as OFAC. OFAC has country-based sanctions programs that ban a broad range of activities in or with a specific country and its government. In some cases the charity needs to get a license from OFAC in order to conduct the activity.

OFAC also has a list-based program that forbids transactions with specific named individuals and organizations. A consolidated list of Specially Designated Nationals or SDNs is available on the OFAC Web site. Violations of these programs can lead to civil fines. Intentional violations are punishable by criminal penalties. The IRS encourages charities engaged in international grantmaking or activities to vet the persons they deal with against the OFAC list. The Commerce Department's Bureau of Industry and Security (BIS) also restricts export of certain equipment and technology to certain countries. Organizations engaged in foreign distribution of computers, for instance, should consult the BIS Web site.

#### Form 990

Now let's discuss information reporting requirements of charities with foreign activities or grantmaking. In general, all tax-exempt organizations must file an annual information return with the IRS. Certain important reporting requirements apply to organizations that conduct foreign charitable programs and grant-making activities.

The core Form 990 for public charities has a checklist, which will determine which of 16 schedules a filer must complete. Questions 14 through 16 in Part IV of the core form cover international activities and grant-making. A "yes" answer to any of the questions will require the filer to complete Schedule F, Statement of Activities Outside the United States.

MARY JO

Schedule F and other Form 990 attachments

Schedule F applies to international activities at any time during the tax year. These international activities include grant making, fundraising, running a trade or business, conducting program services, investing, or maintaining offices for employees or agents.

If an organization has aggregate revenues or expenses of more than \$10,000 from those activities, it must complete Part I of Schedule F. The Schedule F instructions divide the countries of the world into nine regions. For each region in which it conducts activities during the tax year, the organization must indicate the number of offices, employees and agents in the region, the activities and types of program services conducted, and the total expenditures.

If an organization reports more than \$5,000 in cash grants or non-cash assistance to foreign organizations, including foreign governments, on the core Form 990, Statement of Functional Expenses, it must complete Part II of Schedule F

If any foreign organization or entity received a grant or assistance of more than \$5,000, that information must be provided on the table. Enter the region where the foreign organization's principal office is located and details of the grant or other assistance, including its purpose, the amount and manner of disbursement of cash grants, and the amount, description and valuation method of non-cash assistance. The foreign organization should not be identified.

If an organization reports more than \$5,000 in cash grants or non-cash assistance to foreign individuals on the core Form 990's Statement of Functional Expenses, it must complete Part III of Schedule F.

A foreign individual is someone, including a U.S. citizen, who lives or resides outside the United States at the time the grant is paid. Each type of grant or assistance provided directly to foreign individuals should be listed, by region. Grants or assistance provided to individuals through another organization or entity are reported in Part II of the schedule.

Revenues and expenses from or attributable to foreign investments must be taken into account in answering line 14b in Part IV of Form 990. In the case of indirect investments made through investment entities, the extent to which revenue or expenses are taken into account will depend on whether the investment entity is treated as a partnership or corporation for U.S. tax purposes. The instructions require the reporting of activities conducted indirectly through joint ventures.

WARD

Let me give you two examples

Example 1: An organization with an interest in a foreign partnership would need to take into account its share of the partnership's revenue and expenses in determining whether the \$10,000 threshold is exceeded.

Example 2: An organization need not take into account or report any portion of the revenues, expenses or expenditures of a foreign corporation in which it holds an investment, provided it is treated as a separate corporation for United States tax purposes.

If the foreign investment is in a related organization (generally a relationship involving more than 50 percent control by one party or the other) or certain unrelated foreign partnerships, the filing organization may be required to file Schedule R, Related Organization and Unrelated Partnerships, as well as Schedule F. For example, an investment in a 51 percent-owned foreign corporation by the filing organization would be reported on both Schedule F and Schedule R. Supported organizations of a supporting organization should also be reported on Schedules A and R.

Schedule F also alerts filers with foreign investments to other IRS information returns that they may need to file with respect to their foreign investments, including the following:

- Form 926 and 5471 relating to foreign corporations
- Form 3520 and 3520-A relating to foreign trusts and foreign gifts
- Form 8621 relating to passive foreign investment companies and qualified electing funds, and
- Form 8865 relating to foreign partnerships

#### MARY JO

Smaller organizations may qualify for Form 990-EZ or Form 990-N, depending on their gross receipts and assets.

Form 990-EZ filers do not file Schedule F. Instead, Form 990-EZ filers may report foreign activities among the major program service accomplishments, along with the amount of foreign grants. These filers must also attach a schedule itemizing grants and similar amounts paid.

Organizations that are not required to file Form 990 or Form 990-EZ in a given year because their gross receipts are below the threshold reporting level must submit the electronic notice Form 990-N, known as the e-Postcard. The federal tax exemption of an organization that fails to file a required Form 990, 990-EZ, or 990-N for three straight years is automatically revoked. The IRS recently announced the first round of auto-revoked organizations.

#### WARD

All private foundations are required to file Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Trust Treated as a Private Foundation. Certain sections of the form request important information from domestic U.S. organizations that engage in international grant-making activities.

Private foundations that engage in international grant-making must pay particular attention to Part XV. Organizations should provide a thorough explanation of their grant-making guidelines, including:

- How to contact the foundation
- The form preferred for applications
- Any submission deadlines, and
- Any restrictions or limitations, such as program interests and funding priorities

The list of grants paid and approved is one of the most important parts of the private foundation return. This schedule provides useful information about the types of grants the foundation makes and the types of grantees the foundation is looking for.

The minimum information requirements for all grants made during the year (or approved for future payment) are:

- The name and address of each grantee
- The amount of each grant
- The foundation status of each recipient such as public charity, private foundation or non-charity
- The purpose of the grant, and
- The relationship of any grantee to any foundation manager or substantial contributor

It is not sufficient to describe the status as “501(c)(3).” The purpose of the grant should be specified. Descriptions such as “charitable, educational, religious, or scientific activities.” are not sufficient. Describing the purpose as “grant” or “contribution” is also unacceptable.

Acceptable examples of purpose are: “payments for nursing service,” “fellowships,” or “assistance to indigent families.” In addition to providing all the required information, foundations may wish to group the grants by subject matter such as health care grants, environmental grants, and scientific research grants to make it easier for the reader to understand the foundation’s grant priorities.

## MARY JO

A U.S. organization that conducts activities in a foreign country is subject to the unrelated business income tax (UBIT) on its worldwide income, but is entitled to a foreign tax credit.

Under section 515, a tax-exempt organization is allowed to take a dollar-for-dollar tax credit against its UBIT for certain foreign (or U.S. territory) taxes paid. The rules and limitations of the foreign tax credit are found in section 901 of the Code. The tax credit is optional with the organization; in some situations it may be advantageous not to claim it. The credit can be claimed only against federal income tax, not against the section 4940 excise tax on investment income imposed on private foundations. See Publication 598, Unrelated Business Income Tax, for further information.

## WARD

Under the Code provisions dealing with income tax withholding, an organization that makes a payment to a nonresident alien or a foreign organization, such as compensation for services performed in the U.S., may need to withhold tax on a portion of the payment and pay it to the IRS. In certain situations, a grantmaking 501(c)(3) charity may be required to withhold a portion of a grant payment. A detailed discussion of the foreign withholding rules is beyond our scope. See Publication 15, Circular E, Employer's Tax Guide, and Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Entities, for more information.

A grant-making organization must report all grant payments to foreign grantees, even if no withholding is required, except for grants treated as from sources outside the United States and for qualified scholarship payments. Reporting is made by the Form 1042 tax return and Form 1042-S information return. A copy of the forms must be provided to the foreign person; otherwise, the grant-maker risks significant liabilities.

When a foundation is not required to withhold but has failed to collect the required documents, the regulations provide ample opportunities for the organization to obtain proper documentation after the fact and be relieved of penalties. But when a foundation is required to withhold income tax and fails to do so, the regulations provide that the IRS may collect the taxes due from the grantmaker, along with interest and penalties. Therefore, foundations should review their procedures for approving grants to foreign recipients to ensure that they are properly withholding and reporting.

## MARY JO FBAR

If an organization has a financial interest in or signature authority over one or more foreign financial accounts, including a bank account, brokerage account, mutual fund, trust, or other type of foreign financial account, and the aggregate value in such accounts exceeds \$10,000 any time during the calendar year, the organization may be required to report the account yearly by filing Treasury Department Form 90-22.1, Report of Foreign Bank and Financial Accounts, also known as FBAR.

The FBAR is filed with the Department of the Treasury. Do not file the FBAR with Form 990. Form 990, 990-EZ, 990-T, and 990-PF all have their own questions asking the organization to report whether it had any foreign accounts during the calendar year, and if so, to identify the foreign country, and alerting the organization to its possible FBAR filing requirement.

The FBAR is due by June 30 of the year following the calendar year in which the account holder meets the \$10,000 threshold. A grant by the IRS of an extension to file the Form 990 does not extend the due date for filing an FBAR. If an account holder does not have all the information available to file the return by June 30, they should file as complete a return as they can and amend the document when the additional or new information becomes available.

Failure to file an FBAR when required to do so may result in civil penalties, criminal penalties or both. If an organization learns that it was required to file an FBAR for earlier years, it should file

the delinquent FBAR reports and attach a statement explaining why the reports are late. No penalty will be required if the government determines that the late filings were due to reasonable cause. Organizations should maintain financial records of their foreign accounts.

## WARD

We've covered a lot of information today. We don't expect you to remember all of it, and there's still more we didn't have the time to cover.

Don't worry. After you leave this webinar, the IRS has outreach and education resources that can refresh your memory and answer questions you may have regarding what we've talked about here, or other topics of interest to tax exempt organizations.

If you would like to view all or part of this webinar again, or want to recommend it to a colleague, we will be restreaming it in two weeks on the IRS video website at [www.irsvideos.gov](http://www.irsvideos.gov). When you are at the home screen, select "All videoconferences" and find this one, International Activities of Domestic Charitable Organizations, in the list.

You can download the PowerPoint portion of this presentation as a PDF file for later reference, and a transcript if you like. You'll find the icons for these at the lower left of the screen.

The IRS web site has a section that is devoted entirely to tax-exempt organizations. You can reach it at [www.irs.gov/eo](http://www.irs.gov/eo). Or if you're at the main IRS web page, [www.irs.gov](http://www.irs.gov), select the charities and nonprofits tab at the top of the page.

On the charities page, you'll find the most current topics important to tax-exempt organizations and links to more detailed articles explaining how the tax law affects those organizations.

In the left-hand column of the EO page are links to some of the more requested topics. One useful resource is our "lifecycles." We've constructed a number of these for different types of exempt organizations. Viewers of this webinar will probably be most interested in the life cycles constructed for public charities and private foundations. The links in these lifecycles cover in more detail many of the topics we discussed today, and can refer you to other IRS publications and forms

## MARY JO

If you'd like us to send you e-mails to keep you up to date on changes or additions to the Charities and Nonprofits section, we recommend subscribing to our electronic newsletter, EO Update. Click the "EO Newsletter" link on the left-hand side of this page, and follow the directions.

For those of you who want your tax questions answered in person, we still have phone lines. Our toll-free assistance number for exempt organizations is 1-877-829-5500.

Finally some of the tax forms we covered today and others that tax-exempt organizations might need to meet their annual filing requirements are listed on the PowerPoint. You can get copies of these forms by going to [IRS.gov](https://www.irs.gov), or calling the IRS tax forms line at 1-800-829-3676.

Thank you for joining us today. Visit our website anytime, or contact the IRS directly when you have questions. We wish you good fortune in your charitable work here and abroad.