

ED & ER: In Focus

Host: Ted Hart

Guest: David Shevlin - Simpson Thatcher & Bartlett

Announcer: Welcome to the *CAF America Radio Network*, a production of the Charities Aid Foundation of America. As the leader in global giving, CAF America offers more than 20 years of experience and expertise to corporations, foundations and individuals who wish to give internationally and with enhanced due diligence in the United States. Through its industry leading grants management programs and philanthropic advisory services, CAF America helps donors amplify their impact. This show is dedicated to these donors and the charities they support. CAF America is uniquely positioned to serve as the bridge between these important partners and transforms vision into meaningful action.

Guests on the *CAF America Radio Network* are leaders in their field who share tips for success and stories that inspire. Our host is Ted Hart, the CEO of the Charities Aid Foundation of America. This is a live call-in show. Add your voice by calling 914-338-0855. After the show, you can find all of our podcasts at cafamerica.org. Don't forget to dial 914-338-0855. Now, welcome the host of the *CAF America Radio Network*, Ted Hart.

Ted Hart: Welcome to this latest edition of the *CAF America Radio Network*. Our guest today is one of the foremost experts in non-profit law, and is the brilliant mind that CAF America turns to for legal advice in all areas of international grant making. David Shevlin is a partner at Simpson Thatcher & Bartlett, and as head of the exempt organizations practice there. He was recognized by the best lawyers in America as the lawyer of the year for non-profit charities law for New York City, 2014 to 2015. He serves as the chair of the American Bar Association's section on Taxation committee on exempt organizations.

He has a very extensive background and I could take most of the show just reading his resume, but he has his law degree, magna cum laude from New York University, and graduated with honors from Cornell University, where he was named as a presidential scholar. Welcome here to the *CAF America Radio Network*, Dave Shevlin. It would help, Dave, if I turned on your microphone. One second, there you go. Welcome, Dave.

David Shevlin: Thank you, Ted. It's great to talk to you.

Ted: It's great to have you here. Probably without a doubt in the international grant making space, there are a few topics that draw more questions and more interest than understanding our topic today, and that is what is ER what is ED, how are they different? We're going to explore all of this, but why don't we start off with a little bit of your perception of international grant making, what's important, and then we'll get into some of the details here.

David: Sure. I think that the first thing to bear in mind about international grant making is that here's a very complex and extensive tax regime for charitable organizations that wish to make grants outside the United States, but that's only one element of the legal undertaking for an

organization. I'm sure we'll get to some of the granularity and a little bit more detail, but beyond expenditure responsibility and equivalency which are tax rooted concepts, there are particularly post 9/11 and in today's climate a host of know your organization, know your client, any money laundering, any terrorist financing legal regimes that charities are subject to and need to be aware of in fulfilling their international philanthropic goals.

Ted: Dave, why is this necessary work? I often asked you in the United States, if you want to make a charitable contribution and receive a tax deduction to a domestic charity, write a check and you send it to that charity, and you get a receipt and you have a tax deduction. Why is it so much more complex to give to an international charity?

David: For two reasons. For public charities, including organizations that are donor-advised funds-- If I as an individual want to make a gift to a charity and claim a tax deduction, I have to make a gift to a charity that's organized in the United States, even if it's operating or supporting activities outside the United States. That introduces an element to this issue, because I can't make gifts directly to foreign charities and claim a tax deduction. As a result, the Internal Revenue Service is responsible for ensuring that U.S. charities don't act as mere conduits for U.S. donors to effectively make a gift to a foreign charity without the U.S. organization exercising some discretion and control. In addition--

Ted: What does a conduit mean? Because we get asked questions about what is a conduit, I hear that, and acting as a conduit is a no-no with the IRS.

David: That's right.

Ted: Say that again in terms of what is a conduit and why is it a bad thing.

David: A conduit is an organization that isn't exercising its own fiduciary discretion and oversight over the contributions that it receives, and merely acts as a pass-through. If I can't make a tax deductible gift directly to a foreign charity, then I shouldn't be able to make a gift to a U.S. charity and demand that without any further action, discretion, oversight, review by that charity that it merely passes the funds off to a foreign organization. As you know very well, when we are working with us organizations that support international charitable activities, we're very careful to ensure that even if the donor wishes to express a preference or a request as to where the should ultimately go abroad, that the U.S. charity has appropriate protocols and procedures in place so that they are not labeled by the Internal Revenue Service as a conduit.

Ted: As a conduit. Now, the Internal Revenue Service, the IRS in the United States, has provided guidance and regulations that guide how grants can be made internationally and qualified for a tax deduction. Those are two protocols. One is expenditure responsibility, the other is equivalency determination. Let's start by talking about expenditure responsibility. The reason that I choose that one first is because everyone thinks you must have equivalency

determination as if it were the only protocol. I want to explore that one second, what is ER or expenditure responsibility? Why does it exist as a protocol?

David: Okay. Expenditure responsibility and equivalency determination were instituted into the tax code as mechanisms by which private foundations could make grants to foreign organizations and organizations that don't have a determination letter from the Internal Revenue Service that they are exempt and classified as, for example, a public charity. They started as concepts that apply to private foundations, although today these concepts have applicability to donor-advised funds as well. Expenditure responsibility is a process by which a private foundation or donor-advised fund can make a grant to an organization that's not a public charity as determined by the Internal Revenue Service, that includes foreign organizations, foreign charities if they follow a multi-step process.

That process includes pre-grant inquiry by the private foundation, essentially a due diligence exercise of the foreign grantee, an agreement with the foreign grantee that has to contain certain provisions, including provisions to protect the foundation from having its funds diverted. An obligation by the grantee to submit certain reports back to the funder, and a requirement that the funder on its U.S. tax return, which for private foundations is the 990-PF, for sponsoring organizations is the 990, that very report on the expenditure responsibility grants that they had made in the taxable reporting period. It's intuitive, quite frankly, Ted. It's a rather intuitive due diligence, contracting and reporting process.

Ted: Where it becomes quite useful and important is in the international space where international charities which may have projects that are fully charitable would meet with the approval of the IRS under this protocol, but might not in fact be equivalent to a U.S. charity. Does this make it a lesser protocol or one to stand side by side to equivalency determination?

David: They're both very useful and important tools. I would never characterize expenditure responsibility as lesser of equivalency. I think you hit it right. It's a complimentary process, they sit side by side, and different circumstances and different types of organizations call for one or the other or both. Not that you would do both, but you wouldn't have the choice to do both. Sorry, yes.

Ted: Right, exactly, because they look at different things that are meant to qualify and validate that in fact the dollars that are seeking to qualify for a tax deduction in the United States are in fact going for charitable purposes and will be managed as a charitable activity perhaps by a charitable organization. Here at CAF America we often have people contact us who are very philanthropic and very interested in supporting activities that they are familiar with or want to become involved with outside the United States. Oftentimes, before they speak to us they have done an internet search, and on the internet today if you do a search on international grant making, you would almost come to the conclusion that you must have equivalency determination, because there's so much written about equivalency determination.

What I often explain to people is that one of the reasons why there's more written or appears

to be more written about equivalencies determination is because the IRS has published regulations specifically in this area more recently. There has been a lot more activity on the internet related to equivalency determination, but it is not a better, it is in fact as we just said, a complimentary protocol. Let's move on to equivalency determination. You can tell me if I'm right or wrong, why does it appear that there is more about equivalency determination on the internet today than there is about expenditure responsibility?

David: Well, I think for exactly the reason you said. Expenditure responsibility is tried and true, and it hasn't really changed very much in terms of its processes over the years. Equivalency has undergone some recent regulatory tweaking, if you will, and there's been a great deal more activity in terms of folks looking for more efficient ways to to collaborate on their equivalency processes. There have been some fine tuning of the regulations around who can give equivalency determinations, what kinds of documents would and would not satisfy equivalency.

Both of those issues, the collaborative desire around equivalency to economize resources along with some fine tuning by our regulators over what kinds of documentation would and wouldn't suffice, and who's qualified not qualified to give an equivalency determination, has led to I think a good deal more publicity around ED. Again, your statement bears repeating, it's important. It is not a prerequisite to obtain an equivalency determination to make a foreign grant. You can follow the expenditure responsibility process, and indeed there are circumstances that simply don't lend themselves to equivalency but lend themselves much more to it expenditure responsibility.

Ted: Correct. I'll give an example to our listeners, we had a major Fortune 500 company who came to us, who was under the belief that they had to have equivalency determination. They had a list of 30 charities that they knew that they wanted to contribute to, and they had worked with another provider who had appeared to validate that you must have equivalency determination. Going through that process, half of the charities did not qualify, and so they were told that they could in fact not contribute to those charities.

They thankfully found CAF America and we looked at the list and we went through the process. Some of charities were already qualified with CAF America so they were really quite pleased they could start making grants immediately, but we were able to qualify all of the charities, because we work both with ER and ED. I think that's worth noting to our listeners is that both are important protocols, both look at various aspects of charitable activity. Would I be correct-- Again, this is very 30,000 foot and very much an overview, but when I try to help people understand the difference between the two, what I often describe is the expense responsibility looks at the charitable activity itself and therefore has the flexibility to be able to look at all sorts of projects that could, in fact, qualify, and in fact, could be managed by a for-profit organization for charitable purposes.

Whereas equivalency determination is looking at the charitable entity itself to determine if it in fact, if it were in the U.S., could in fact be found to be equivalent to a U.S. 501(c)(3) charity.

That's where in the international space both protocols become so important, because when you're talking about a very big planet with a lot of different legal structures all around the world, oftentimes the notion that we have here in the United States of what is a charitable entity does not exist in other countries, but yet there is philanthropic work being done. Is that too simplistic?

Ted: No. I think what's important for people to understand and bear in mind is equivalency means that the entity is the equivalent, not just as a 501(c)(3), but as a public charity in the United States. To your point, you may have an entity outside the United States that is for-profit, or maybe it's a private foundation outside the United States, or maybe it's an organization that could potentially be a public charity in the United States. To undertake the the process of reviewing its financials to see if it has the relative numerical tests satisfied is just such an undertaking that you tilt towards expenditure responsibility.

People sometimes say to me, "If something is not available for an equivalency determination, how could you get satisfied that it would pass ER?" And it's for the reason that you just said, which is the organization may not be literally and strictly the equivalent of a public charity, or the process to get there may just be too onerous and expensive, but the activity that you are intending to support is indeed charitable, and as long as you obtain the necessary documentation in the form of an agreement and report, and you've done your due diligence to ensure that your funds will be so spent, then you've satisfied the expenditure responsibility requirements.

Ted: Again, both protocols are extremely important, and are tools in the toolbox that makes sure that not only the regulations of the IRS are followed, but also seeks to provide a structure and support for the donor and ensuring that the money is spent correctly. One of the things that we often share regarding equivalency determination, because again, we get asked a lot more questions about equivalency determination for the purposes that we spoke of earlier, is that it is not a license to give or a license to grant. In other words, once I just go and get an ED certificate because it's possible to get that, I can just go ahead and send the grant and I don't have any other obligations or worries. Would that be a true statement?

David: You and I have talked about this frequently. You know this is a big issue for me because there-- And as I started this conversation, the tax code is an important element of an U.S. charitable organization's activities outside the United States. Assuring the donors that you're not a conduit for their deductibility, ensuring that you follow these processes so that you're not subject to penalty excise taxes under the tax code, all critical and indispensable. That said, we have several regulatory regimes, and I'll just start by naming a few.

There's the Patriot Act, which penalizes and criminalizes funding including through humanitarian support of activities that facilitate terrorist activities. We have Foreign Corrupt Practices Act, which criminalizes the payments of foreign government officials to obtain a business advantage. We have the OFAC regime, which sanctions certain activities in specific countries, and in certain countries even to engage in humanitarian activities you need a license.

Like you said, ER, ED, part of a toolbox, steps in the process, but not in and of themselves sufficient without thinking about whether or not you need to take further steps to ensure compliance with the broader array of regulatory rules that are out there for foreign financing.

Ted: Dave, we're going to take a very quick break, and when we come back we'll have about nine minutes left on the show. One of the topics I'd like you to take up when we come back is the notion and the topic of written grant agreements. Are they're required, what should they cover. We'll be right back.

Announcer: Remember, our podcasts and archives are always available 24 hours a day at cafamerica.org. If you're listening today, our phone lines are open. Call in and ask a question by dialing 914-338-0855. Now, back to the *CAF America Radio Network* and our host Ted Hart.

Ted: We're back here live with Dave Shevlin, partner at Simpson Thatcher in New York. Dave, what is grant agreement? Is it required, what should they cover, why is this a topic that would be part of this discussion today?

David: A grant agreement is a contract between the funder in our scenario that we're talking about today, the U.S. funder and the grantee, again in our scenario, the foreign organization that specifies the terms by which the U.S. funder will make the grant to the foreign grantee. That's what the grant agreement is. It is strictly required to satisfy expenditure responsibility. Expenditure responsibility requires that you have a grant agreement that clearly specifies the purposes of the grant and requires the grantee to repay amounts that aren't used for the grant, to submit reports, and to keep records, and to prohibit the grantee from using the funds for non-charitable purposes, including lobbying, political activities or the like.

In that context, it's required. It's not strictly required under equivalency. However, certainly I think it's pretty common practice. Certainly amongst my clients, the default rule is that you should have an agreement with your grantee regardless of whether or not you're following expenditure responsibility, because-- Go ahead, sorry.

Ted: I was just going to say I think you may have been going to the same place because there are so many other factors in terms of your due diligence that without that you could unwittingly be sending money and allowing money to be spent for purposes in which if there's no agreement, you may not have oversight.

David: Without an agreement, you're not obtaining the representations and warranties, and confirming that the grantee assures you that the funds wouldn't be spent for non-permissible purposes. Regardless of whether or not on following ER, why wouldn't I want the grantee to contractually obligate itself to me that it will use the funds for the specified purposes that we have in writing what those purposes are, and that we have representations as to their ability to comply with their applicable laws, et cetera. To me, it doesn't take much convincing when I'm speaking with a client to say, "Even if we're going down the equivalency route, we're going to have a grant agreement with this grantee to lay out all the terms of the grant."

Ted: Again going back to the concept that an equivalency determination certificate is not licensed to grants, there are other things that you need to take into consideration, such as re-granting and lobbying. Where does that fall into the regulatory regime?

David: Re-granting is, as the term would imply, the situation where you're making a grant to an organization and either with respect to the whole grant or part of the grant, they're going to grant it to another organization. The way expenditure responsibility works in particular is that if there is re-granting, there has to be expenditure responsibility of what we call the secondary grantee. You do have to be on the lookout for whether re-granting is contemplated or part of the process. With respect to lobbying, private foundations, for example, by and large with some minor esoteric exceptions are not permitted to engage in lobbying of any type.

While public charities can engage in an insubstantial amount of lobbying, private foundations may not, so it's important that when a private foundation funds an organization, if it's funding a specific project that it knows that the funds that it's funding are not being used for any lobbying portion of that project. When a private foundation makes a grant, whether it be a grant that we use equivalency or expenditure responsibility for, I want to know that my client's funds aren't being used to support activities that they wouldn't be able to support here in the United States, such as lobbying. That's an important part of that process.

Ted: It's an important part. Another important part is reporting. What is reporting, what are the requirements, and beyond requirements, what are best practices?

David: It's a good question because to me it's similar to the agreement, there's, "Do I have to have a report," and there is, "Should I have a report." The answer to, "Should I get a report," is yes, regardless of the process that you follow. I think that we've spoken quite a bit here today about all of the external legal and regulatory issues that overlay grant making outside the United States, such that it's common sense to obtain a report that shows you the evidence the grantee use the funds for the purposes for which you intended them to be used.

That's a should in all cases. The must is in the expenditure responsibility scenario where you are required by the terms or the regulations to obtain a report, financial and a narrative report, on an annual basis plus at the conclusion of the grant. You are required to get the report pretty much for the life of the grant. There's a lot of rules and thinking around how long these reports have to be made, and we won't get to them in three minutes, but at a very 30,000 foot level, essentially get reports every year for the duration of the grant.

Ted: Right. Wrapping up, as you're watching the clock as well. The three minutes that we have, just wrapping up again, our topic today is equivalency determination and expense responsibility in focus. How would you wrap up your best advice for those who are looking to give outside of the United States?

David: I would say, number one, be conscious of the tax regulations which require you to have a robust diligence and contractual and reporting process, regardless of which path you choose to grant outside the United States. Number two, be aware of the significant non-tax legal concerns that exists for grant making outside the United States, including Patriot Act and OFAC,

and understand that equivalency is an excellent tool, but it is not the only tool and it is not in and of itself a sufficient and exclusive tool to use.

Ted: Dave Shevlin, partner at Simpson Thatcher, one of the bright lights in international grant making and certainly helps us here at CAF America to serve all of our clients in the very best way we can. I want to thank you so much for being my guest here today on the CAF America Radio Network.

David: My pleasure, Ted.

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