

## **Latest from the IRS: Is the Landscape of International Philanthropy Changing**

Host: Ted Hart

Guest: Elizabeth Kingsley - Harmon, Curran, Spielberg & Eisenberg, LLP.

**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.

Guest 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](http://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 here to this latest edition of the *CAF America Radio Network*. We have a very important topic today. It's not all that often that the IRS issues new treasury regulations, specifically today, as we've discussed here on the *CAF America Radio Network* before, there are two protocols that allow for US citizens to receive a tax deduction while supporting international projects and charitable causes. One is called expense responsibility, and our topic of today are the new treasury regulations related to equivalency determination.

Our guests here today on the *CAF America Radio Network* is Elizabeth Kingsley, she's with Harmon, Curran, Spielberg & Eisenberg, LLP. Beth has a BA from Oberlin College and a law degree from Georgetown University Law Center. She's a noted expert in areas related to nonprofit organization, political campaigns, providing a full range of general counsel services to a variety of nonprofits, including private foundations, associations, community-based groups, national and international public interest organizations. More importantly, she's here on the *CAF America Radio Network* to help us understand these new regulations. Welcome here to the show Elizabeth Kingsley.

**Elizabeth Kingsley:** Well, thank you very much. Glad to be here too.

**Ted:** Elizabeth, the IRS does not issue regulations of this sort all that often, the initial proposed regulations were issued in 2012. Did the IRS make any clarifications on why it's taken three years for the final regulations?

**Elizabeth:** Well, they didn't explicitly address that question, but I have to say the pace at which the IRS moves in terms of issuing guidance is not typically fast. Three years is not shocking to some of--

**Ted:** Sooner than most of us expected I think.

**Elizabeth:** I think that's right now. [unintelligible 00:03:47] that have been hanging out there for longer.

**Ted:** This obviously was something that required attention.

**Elizabeth:** It did. Although, one of the things I think that made it less pressing for them was that when they issued the proposed regs in 2012, they said the private foundations could rely on them. Even though they weren't effective yet they were proposed. Private foundations were allowed to rely on them to be protected against potential penalties. The donors who they were regulating with these regs weren't quite as anxious to have it finalized as they might be if it had just been proposed.

**Ted:** Just proposed, right. Well, CAF America as you know has been conducting its operations based on the initial regulations since they were proposed in 2012. Most of the changes are pleasing to CAF America and that they're endorsing our current practices, but for the purposes of today wanting to be informative to all those who are listening to the show today. What is new and how do the final regulations differ from the initial ones proposed in 2012?

**Elizabeth:** To be clear, the 2012 proposal was updating regs that are currently on the books and have been for years, and I think the biggest change is just to take a step back in making the international grants doing an equivalency determination. A funder that is subject to those rules has to make a good faith determination and a reasonable judgment about the 501C3 equivalency status and the public charity equivalency status of the donee. That's generally, if you make a good faith determination reasonable judgment, then you are protected.

The question is, what is sufficient? What qualifies? Is there a way to be absolutely sure the IRS will find your determination to be adequate. It used to be that you could rely on an affidavit from a grantee that made certain representations, and that was sufficient. If a grantee was willing to sign under penalties of perjury that certain things we're true about it, you could rely on that and be protected against excise tax penalties. The IRS has taken that away as a per se protective measure. It doesn't discourage the use of affidavits to get information about the grantee and on which to base that determination, but the affidavit alone is not going to be sufficient.

The other thing that the new rules have done is to expand the class, and this is not a change from the proposal, but the regs that had been on the books until 2012 required that a fund-- and they only applied to foundations. We're still waiting for Donor-advised fund regulations to be issued, but we know they can rely on this new set. What the old rules said was that, a foundation can rely on an opinion of counsel for itself or for the grantee. The problem is, that means, typically, the foreign grantee doesn't have US tax counsel to give them an opinion about their status.

**Ted:** Right.

**Elizabeth:** Foundation A gets an opinion from their advisor, foundation B now wants to make a grant, they can't rely on that opinion because it's not their counsel. That really raises the borrowing costs for overseas giving. Now, you're allowed to rely on-- First of all, it doesn't have to be legal counsel. It can be a qualified tax practitioner, and it's clear that an opinion issued by counsel for one foundation can be relied on by other donors.

**Ted:** Let's go back to the affidavit because I think that is a very significant change for a lot of folks who were doing what CAF America might have considered a little bit more like equivalency determination light, in putting too much emphasis on the affidavit, which of course, CAF America never has. We've always substantiated the information and looked for additional guiding information in making our equivalency determinations.

From our perspective, this is a very important move to make sure that when you're talking about good faith determinations, it's not a hope and a prayer good safe kind, it's that you really have done your homework and that you have done the due diligence in making that determination.

**Elizabeth:** I think that's really true and it's clear that the opinion that an organization should rely on has to set out the fact, it can't just be an opinion that this is an equivalent organization. You really have to do the inquiry that the IRS would do if it were ruling on the exempt status of an organization.

**Ted:** It is a pretty high bar. I think one of other things that we owe it to our audience to make sure that we clarify today, is that working through an intermediary like CAF America provides additional protections in that an organization like CAF America will take on full risk for making the grant if the grant has made through an intermediary like CAF America. Another organization that might just offer a certificate or you might be sharing the good faith determination that was done for another grant is certainly within the regulations but requires the grantee to take full risk for that grants as well.

**Elizabeth:** That's true, yes, and that is the benefit of working through an organization like CAF America as you say, that you take on the responsibility of doing all of the due diligence and making the good faith determinations. That is one of the real upsides within that kind of arrangement.

**Ted:** I want to make sure that we just clarify that because I think these regulations are very important in helping understand what are the best practices. We see them really a serving endorsement of best practices that CAF America has had in place for many years. You mentioned Donor-advised funds and certainly the IRS is looking at a number of different issues where there may be additional regulations. There's certainly a number of years ago as part of the pension Protection Act were issued a number of different clarifying statements regarding Donor-advised funds. Donor-advised funds are specifically mentioned in these regulations as well, it clarifying what might have been seen as sort of a gray area, could Donor-advised funds actually rely on these regulations or not. Specifically in these regulations say, yes, they can.

**Elizabeth:** Well, there's a lot of questions that Donor-advised funds are still waiting for the IRS to answer as they try to comply with these are pension protection act. Nine years later we still don't know exactly what all the rules are, but this is a step forward and that it really does make clear that Donor-advised fund can rely on this the same way foundations can.

**Ted:** Exactly. This written advice must be current having a substantial factual basis and relying on legislation that is currently in effect yet, an attorney client relationship is not necessary. Is this a change from the proposed regulations or can foundations ensure that the written advice is current?

**Elizabeth:** It is a change from the previous regulations in the broadening of the class of the counsel on his advice that any entity can rely. In terms of making sure something is current, I mean, to me, that's something that would ideally be addressed in the written advice and the written opinion because you'll want to know how long you can rely on it for. Usually, at least for-- if you have issued in a current fiscal year, it should be good through the end of that fiscal year.

There are actually two aspects to that because there is an issue about the C3 qualification. That's less likely to change unless the grantee really radically changes its activities. Then there's the public charity status which for those organizations that rely- for that status, to rely on the sources of income, you need to re examine that every year. There's a rule about how long you can rely on that which parallels the rules for US public charities.

**Ted:** Again, clarifying the procedures that this brings it closer to what it was really intended to be, which is equivalency determination that is this foreign charity ostensibly in a good face substantiated validated way the same as and would qualify for US public charity status. Would there ever be circumstances where the current advice remaining valid for a subsequent two year period after the five year test period for public charities, that would not hold true?

**Elizabeth:** There is a two year reliance period for organizations that are subject to the five year test period. For organizations whose public status is not based on their sources of support, you probably need to reaffirm that every year. Is it still a school, is it still a church, is it still a hospital, but that's a fairly straightforward process.

**Ted:** So, it's not an automatic- I think my questions was leading to, it's not an automatic set amount of time. Again, it goes back to what I refer to as a reasonable person rule, that you don't just do the determination say, "Okay, there it's good for two years." You really have to look at the specific data related to that equivalency determination to determine, how did they qualify and is that likely, again, to a reasonable person, is that likely to change within the qualification period?

**Elizabeth:** Yes, that's right. It's something you should evaluate at the outset when you're doing the initial determination and then when you're following up, presumably, and-- again, ideally, a funder will have had some engagement with the grantee. Will have heard how they use the grant funds, and they can have a sense of what program activities they've been carrying on and

how they're doing financially and get an idea of whether the ground has really significantly shifted.

**Ted:** It's also important if you could speak to the point of, the equivalency determination is an evaluation of the charity itself, and the way that they do business and who they are and the support that they have. This is a pretty rigorous process that can take some time to accomplish.

**Elizabeth:** It certainly can. Especially as very aware, when you're working cross border with organizations that are not familiar necessarily with the principles of US tax law, and not necessarily familiar with how charitable is defined for tax purposes, whether a language barriers. You want to be really clear that they understand some of the assertions they're making about what they do and how they carry out their purposes. It does take some work to really get together the information necessary to come to that conclusion.

**Ted:** Most of us who are in this particular space within the philanthropic community are aware of the fact that there are some that are out there unfortunately who bend the rules a little bit and might make international grants using what I refer to as the smell test. "If it smells like a charity, looks like a charity, we think it maybe a charity." They'll go ahead and make the grant, I'm calling it equivalency determination because we use the good faith approach. Good faith approach has to be based on the substantiation of an actual review.

It isn't just, we really think in our heart of hearts we have faith that they are a good charity. You speak to how important it is for, particularly, I think corporations and individuals who are looking to meet the regulations to ask lots of questions and look under the hood as to what kind of equivalency determination is actually being done here.

**Elizabeth:** Well, that's right. To be able to rely on these rules and to properly be making grants to foreign grantees that are considered charitable for US tax purposes, you need a really substantive factual inquiry, actually factual and legal inquiry because there are questions you have to ask about how the organization works, what its purposes are, what its operations are, who it serves, how it makes available its services, and that sort of question. As well as understanding some of the more technical things such as whether it is allowed to engage in substantial amounts of lobbying or in political campaign intervention.

A lot of other countries do not necessarily directly address that in their laws in the same way that we do. Really, drilling down and understanding how the organization operates and what rules it is subject to, is a non-trivial inquiry. Again, it's a good thing that IRS is making it easier and it's good thing we have organizations like CAF America that will do that once and then allow various funders to be able to support grantees so that you don't have to reinvent the wheel with respect to each foreign grantee that you're looking at.

**Ted:** If you can weigh in on this, I see these regulations as not necessarily making the equivalency determination process easier, but making them more accessible because it really seems from our perspective at CAF America, that this is a set of regulations that really hard wires the best practices.

**Elizabeth:** That's right. When you say, "It's not making the determination easier," I think if anything is-- It made it a little harder, and I think not necessarily in a bad way as you've highlighted, by removing heavy reliance on the affidavit. You can't just have a foreign charity check a bunch of boxes that say, "Yes, I'm not allowed to lobby. Yes, I'm not allowed to engage in political campaign intervention," when they don't necessarily know what those terms mean, and say, "Okay, we've done our due diligence."

**Ted:** I'm so glad you said that because I think that that's one of the substantial things that corporate executives and philanthropy executives, individuals, home offices, those who are looking to support charitable causes outside of the US need to understand that that's one of the reasons why the change was made because we're literally asking charities in another country with a different set of laws and cultural norms to answer questions that are very relevant to US charities, that are very relevant to the US philanthropic sector that may have very different meanings or may be interpreted in very different ways around the world.

That's where it takes a professional like working with CAF America, and you certainly are actively involved in supporting our efforts as an expert in this area. It takes that kind of deep due diligence to make sure that you get it right.

**Elizabeth:** It's clear now that, in order to have the legal protections the technical protections under the income tax rates, there has to be a factual inquiry and written advice that includes facts sufficient to allow the IRS to confirm the determination. It's not just checking the box and putting a piece of paper in the file.

**Ted:** You're bringing up the-- So, the flip side of this is, we now have these regulations and part of what is important about these regulations, is that when you follow them you are then compliant and have legal protection to the grant that you've made. I'm going to share with you a scenario and I think I know the direction you're going to go in with this, but just for purposes of our listeners today.

We're aware of unfortunately, some who have made grants, who have taken a look at the fact that CAF America is known for having the gold standard in due diligence and vetting of projects and charities, where they'll say, "Well, we're aware of the fact that CAF America made a grant to that charity. It must be safe and it must be okay and so we'll go ahead and do that." What's the pitfall of that backhanded back alley way of making an international grant?

**Elizabeth:** Well, that's very flattering to you, no doubt, but it definitely gives them the protection. It's not a good faith determination, just to point to someone else and say, they must have made a good faith determination. They are allowed to rely-- an opinion of counsel can be shared with multiple funders, but you can't just rely on the fact that that other funder must probably have gotten an adequate opinion or done its due diligence and conducted a factual inquiry, so I don't need to worry about it. I mean, that's one of the problems of the old reg that has been partially addressed, but each funder-- [crosstalk]

**Ted:** We're so pleased to see that. We really feel like it puts those ED light groups out of business because anyone who cares about having legal protections and protecting the charitable contribution deduction that they've earned by going through and meeting the standards of the regulation, all that's wiped away if you don't in fact follow the regulations.

**Elizabeth:** Exactly right. It doesn't give you protection. There's two levels of protection. There's this, you have met this, what's called the special rule, that the IRS will presume your determination was made a good faith, but if you haven't done-- you can also be under the general rule which just says any good faith determination. That doesn't necessarily require an opinion of counsel, but it requires something. Something fairly substantive from the organization. If you haven't even done that, not only are you not covered by the special rule with the favorable presumption you haven't made a good faith determination, so you're really subject to penalty taxes.

**Ted:** Pretty substantial penalty taxes for getting that wrong. Now, treasury is allowing a 90 day period for foundations to comply with this change. I guess there's a window where those who have not been in compliance, it's really a call out to everyone who is doing international grant making to check with whoever your provider is and really use these 90 days to look under the hood to make sure that you understand what kind of compliance you are actually being represented for.

**Elizabeth:** That's absolutely right. It's important that the 90 days is-- I mean, it makes sense if you've already got a grant that's in the pipeline that you're about to issue. You've made a commitment or you've made maybe a non binding commitment and suddenly the rules change, it would be really unfair to just shut that down automatic without any warning.

A transition period is good, but the transition period should be a chance for foundations to really move so that grants they are making after the end of the 90 days definitely comply with these regs, and it takes some time to get that regime in place. I mean, 90 days is a fairly short period of time if you haven't been doing the factual inquiry and the due diligence. Anyone who is rely on an affidavit.

**Ted:** If you haven't been doing-- exactly that. We can tell the difference here at CAF America because we've been getting so many phone calls from folks that maybe have had in the back of their mind, "I wonder if the process that that group that's representing that we're making our national grant making and doing that for almost no charge at all. It's very simple, it's easy," have this period of time to questions to say, "You know it's a pretty complicated set of regulations. Is it really able to be done in a couple of hours and it is able to be done for almost no fee." How do you answer that?

**Elizabeth:** Well, it's not possible to do in a couple of hours. I mean, it requires specific facts, it requires back and forth with the grantee, and it requires legal analysis. It is true the regulations have now expanded the class of practitioners who can give that opinion, it's not just a lawyer, but it still has to be a qualified tax practitioner. It can't just be someone off the street who says, "Yes, this looks like a charity."

**Ted:** Yes, "Looks like a charity. I'll sign off." It does have to be someone who could stand behind the determination that if there's an audit or it's called into question, whoever is providing that service has to be able to answer very detailed questions about how the determination was done, and the fact that you did no review and gathered no information is not going to look well in front of the IRS.

**Elizabeth:** That is not a good faith determination or a reasonable judgment. I mean, it's just not.

**Ted:** Final analysis, we have just a couple of minutes left. Let's summarize what has happened, why is this significant, and for funders who are looking to eliminate risk, are looking to ensure regulatory compliance, and let's face, and protect the reputations for getting it right, what do these regulations mean?

**Elizabeth:** Well, these regulations provide a clear pathway. They're the clear definition of what you need to do, what kind of opinion you need to get, that it does need to be in writing, that there's a certain group of people who can provide it. It clearly requires a factual inquiry and going through that process of working with an organization that knows how to go through that process is going to offer the protections of the presumption that you have done the right thing. Even if the IRS comes in down the road and looks really closely at the foreign grantee and says, "I think your judgment was wrong."

You still get the credit for having made a good safe judgment on the question and therefore, avoid penalty taxes. Penalties taxes which, by the way, apply not just to the organization but potentially to its managers who approve some of these things. Personal liability is something that most foundation managers will want to avoid and to follow in this roadmap.

**Ted:** It really does matter that you get it right. Good faith determinations, I almost feel like is a little bit of a misnomer because it takes more than face to get this done. It really does take a lot of effort and skill, and certainly you bring that to the table.

We've enjoyed working with you and the expertise that you bring to helping support the CAF America program. Elizabeth Kingsley, you have been a fountain of information today. We very much appreciate the expertise that you bring to the table, and together we'll continue to set the standard for good equivalency determination and superior international grant making. Thank you so much for being my guest here today on the *CAF America Radio Network*.

**Elizabeth:** Thank you very much Ted.

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