

Henderson & Caverly Pum & Charney LLP

EXEMPT ORGANIZATIONS NEWSLETTER

May 2017



INTERNATIONAL GRANT MAKING

BY U.S. PUBLIC CHARITIES

On occasion, conducting charitable work necessitates broadening a charitable organization's reach, which may, in turn, require working outside of the United States. In general, a public charity may conduct part or all of its activities in a foreign country as long as the activities are consistent with the charity's exempt purposes. A charity may operate abroad through a foreign branch office or subsidiary (See [PLR 201438032](#) and [IRS EO Continuing Professional Education Text: Domestic Organizations with Foreign Operations](#)). It may also make grants to foreign

organizations and individuals. Unfortunately, the lack of knowledge of the complex U.S. and foreign laws and the onsite verification and documentation needed to comply with the strengthening of U.S. tax-exempt, finance, and anti-terrorist laws are exposing nonprofit organizations to increasing liability and even criminal violations.

Grants to Foreign Organizations and Individuals

A public charity may make grants to any organization (foreign or domestic) or individual that uses the grant for activities consistent with the charity's exempt purposes.

Organizations

A public charity will not jeopardize its tax exemption by distributing funds to organizations that are not charities. The charity must, however, ensure the use of the funds for permitted purposes by limiting distributions to specific projects that further the charity's own charitable purpose. The charity must retain discretion and control as to the use of the funds and maintain records showing that the funds were used for its exempt purposes.

The IRS has provided guidance on discretion and control in the circumstance where a U.S. public charity is specifically formed to support a foreign charity or charities. This type of organization is commonly referred to as a "friends of" organization. A "friends of" organization is established because contributions to foreign charities are generally not tax deductible. A donor to such a U.S. charity may be denied a charitable income tax deduction if the IRS determines that the charity is the agent of the foreign beneficiary or a conduit organization. A charity will not be considered a conduit organization if it exercises discretion and control over the funds solicited.

In conducting their foreign activities and grantmaking, charities should be mindful of the sanction programs of the Treasury Department's Office of Foreign Asset Control known as OFAC (discussed below). OFAC has programs that ban a broad range of programs in or with certain countries. In some cases a charity

may need to obtain a license from OFAC in order to conduct the activity.

Individuals

In order to substantiate that distributions to individuals are appropriate, the IRS requires that a charity maintain adequate records and case histories including:

- the name and address of each recipient;
- the purpose for which the aid was provided;
- the manner in which the recipient was selected;
- the amount distributed to each recipient; and
- any relationship between a recipient and the officers, directors, and substantial contributors of the charity.

These records must be maintained by the organization itself and must be able to be substantiated upon request by the IRS. For example, in [PLR 201001024](#), the IRS denied 501(c)(3) tax-exempt status to an organization because the organization did not keep records of the eligibility of students who were receiving their aid.

Best practices for public charities making foreign grants include:

- requiring review and approval of all grants by the board of directors;
- entering into a grant agreement with the recipient committing the recipient to use the funds for charitable purposes;
- requiring recipients to furnish periodic accountings to show that the funds were expended for the charitable purposes approved by the board; and
- maintaining proper records regarding recipients.

Charities distributing short-term emergency assistance are expected to maintain documentation such as:

- a complete description of the assistance;
- cost of the assistance;
- the purpose for which the assistance was given;
- the charity's objective criteria for disbursing assistance under each program;
- how the recipients were selected;
- any relationship between the recipient and officers, directors, or key employees of or substantial contributors to the organization;
- date, place, and estimated number of victims assisted; and
- the composition of the selection committee approving assistance.

A charity that distributes aid for short-term emergency assistance is not expected to maintain record of the name, address, and amount distributed to each recipient. Examples of such short-term emergency aid include blankets, hot meals, crisis shelter, coats, hats, and gloves. For additional information, see [IRS Publication 3833, Disaster Relief: Providing Assistance Through Charitable Organizations](#).

Anti-Terrorist Financing Laws

In addition to tax laws specifically governing public charities, charities must also comply with anti-terrorist financing laws applicable to U.S. individuals and entities, including Executive Order 13224 and the USA PATRIOT Act.

Executive Order 13224

On September 23, 2001, President Bush issued [Executive Order 13224](#). The Order:

- blocks the property of foreign persons listed in the Executive Order, i.e., Specially Designated Global Terrorists ("SDGTs");
- blocks the property of individuals and organizations that assist, sponsor, or provide financial, material, or technological support for terrorism, SDGTs, or unnamed persons determined to be subject to the order;
- blocks the property of those who are otherwise associated with SDGTs or unnamed persons determined to be subject to the order; and
- prohibits U.S. individuals and organizations from engaging in transactions in blocked property, including making or receiving any contribution of funds, goods, or services for the benefit of

SDGTs or unnamed persons determined to be subject to the order. This prohibition includes humanitarian aid.

If a charity violates the Order, its assets can be blocked and its tax-exempt status revoked. The charity may also be subject to criminal and civil penalties. Unlike the USA PATRIOT Act, the Executive Order does not have a knowledge or an intent requirement. In other words, a charity can violate the Order even if it does not know it is providing support to an SDGT.

As part of its enforcement efforts, the OFAC publishes a list of individuals and companies owned or controlled by, or acting for or on behalf of, targeted countries. It also lists individuals, groups, and entities, such as terrorists and narcotics traffickers designated under programs that are not country-specific. Collectively, such individuals and companies are called "Specially Designated Nationals" or "SDNs." Their assets are blocked and U.S. persons are generally prohibited from dealing with them. The SDN list includes those individuals and organizations listed on the SDGT list. To access the [OFAC's SDN list](#), see the U.S. Department of Treasury's website.

USA PATRIOT Act

In October 2001, Congress enacted the USA PATRIOT Act, which enhanced existing criminal penalties for knowingly or intentionally providing material support or resources for terrorism or to foreign terrorist organizations. On March 9, 2006, President George W. Bush signed the USA PATRIOT Improvement and Reauthorization Act of 2005, which makes permanent many of the temporary provisions of the original Patriot Act, enhances certain criminal penalties, and expands the reach of search and seizure.

The Patriot Act imposes fines and terms of imprisonment of up to 15 years for providing material support or resources with the knowledge or intention that they are to be used in terrorist acts or by foreign terrorist organizations. If the terrorism results in the death of any person, the maximum penalty is life in prison. The Patriot Act also creates civil liability, enabling those injured by a terrorist act to sue those who funded the group for treble damages, costs, and attorneys' fees.

Material support or resources include any property, tangible or intangible, except medicine or religious materials, or any service, including financial services, lodging, training, expert advice or assistance, safehouses, personnel, and transportation.

In addition, Congress enacted Internal Revenue Code Section 501(p) (Suspension of Tax-Exempt Status of Terrorist Organizations), which provides a number of consequences for a charity that is identified as a terrorist organization or a supporter of terrorism. Pursuant to Section 501(p), the tax-exempt status of the charity is suspended and no deduction is allowed under any provision of the Internal Revenue Code for any contribution to the charity during any period in which the charity's tax exemption is suspended.

To assist charities in complying with these laws, the Treasury issued the guidelines discussed below.

Treasury Guidelines

In response to the terrorist attacks of September 11, 2001, the U.S. Government launched and maintained a comprehensive campaign against terrorists and their support networks, including the sources and conduits of terrorist financing. Investigations carried out during this campaign revealed consistent terrorist abuse of the charitable sector through the diversion of charitable funds and services to terrorist organizations such as al Qaeda and Hamas. In response to this threat, and to assist charities in adopting protective measures against terrorist abuse, the U.S. Department of the Treasury developed and released in November 2002 the *Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities* ("Guidelines"). On December 5, 2005, Treasury released a revised draft Guidelines for public comment and requested comments on the revisions. Treasury, after careful consideration of the submitted feedback, modified the Guidelines to address the specific concerns of commenters.

Although adherence to the Guidelines is voluntary, they do not constitute a legal defense against any civil or criminal liability for violating any local, state, or federal law or regulations. The measures are intended to build upon pre-existing controls and protective measures already in place, and may also assist charities in complying with U.S. law such as the OFAC sanction programs.

The Guidelines' anti-terrorist financing best practices state that charities should apply a risk-based approach and acknowledge that not all of the steps may be applicable or appropriate. These steps include:

- gathering detailed information about the grantee;

- conducting a reasonable search of public records to ensure that the grantee is not suspected of activity related to terrorism;
- checking OFAC's master list, noted above, to make sure that the grantee does not appear as well as grantee's key employees, directors, and other senior management;
- conducting a reasonable search of publicly available records to ensure that the charity's own key employees are not reasonably suspected of activity related to terrorism; and
- requiring grantees to certify that they do not deal with anyone subject to OFAC sanctions, known to support terrorism, or to have violated OFAC sanctions.

At a minimum, a charity should check the OFAC list (a link is provided above) as part of its normal prefunding due diligence. The charity should check the names of the direct recipients of the funds and the names of the recipients' key staff and board members. The charity should also keep records of its grant procedures and risk assessments.

Funded by the Bill and Melinda Gates Foundation, the Charity & Security Network performed a comprehensive study to determine the scope and nature of the de-risking challenges faced by U.S.-based nonprofits working overseas. The report is titled "*Financial Access for U.S. Nonprofit Organizations*" and is available on Charity & Security Network's website.

Additional resources to protect charitable organizations making grants to foreign organizations are available on the [U.S. Department of Treasury's](#) website.



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