August 14, 2013

Mr. Daniel Werfel
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20024

Re: Comments Concerning Proposed Regulations for Reliance Standards for Making Good Faith Determinations

Dear Acting Commissioner Werfel:

Enclosed are comments concerning proposed regulations for reliance standards for making good faith determinations. These comments represent the view of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Michael Hirschfeld
Chair, Section of Taxation

Enclosure

cc: Mark J. Mazur, Assistant Secretary (Tax Policy), Department of the Treasury
    William J. Wilkins, Chief Counsel, Internal Revenue Service
    Emily S. McMahon, Deputy Assistant Secretary (Tax Policy), Department of Treasury
ABA SECTION OF TAXATION

COMMENTS CONCERNING PROPOSED REGULATIONS FOR RELIANCE STANDARDS FOR MAKING GOOD FAITH DETERMINATIONS

These comments ("Comments") are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Morey Ward of the Exempt Organizations Committee of the Section of Taxation. Substantive contributions were made by Andras Kosaras, Robin Krause, Janice Rodgers, and Barbara Rosen. The Comments were reviewed by Suzanne Ross McDowell, Chair of the Exempt Organizations Committee of the Section of Taxation, James K. Hasson, Jr. of the Committee on Government Submissions of the Section of Taxation, and Michael A. Clark, Council Director for the Exempt Organizations Committee.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal tax principles addressed by these Comments, no such member or the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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Date: August 14, 2013
EXECUTIVE SUMMARY

Section 501(c)(3) tax-exempt organizations classified as private foundations are potentially subject to penalties in the form of excise taxes under sections 4942 and 4945 if they make grants to organizations that are not classified as “public charities” under section 509(a). These potential penalties are of particular concern where a proposed grant recipient is organized under the laws of a country other than the United States. On September 24, 2012, the Department of the Treasury (“Treasury”) issued proposed regulations (the “Proposed Regulations”) regarding the standards for making a good faith determination that a foreign organization is equivalent to a U.S. public charity, grants to which may be treated by private foundation grantors as qualifying distributions and not taxable expenditures. The Explanation of Provisions accompanying the Proposed Regulations sought public comment on the following questions:

- Whether it is appropriate to limit the timeframe during which a private foundation is permitted to rely upon a qualified tax practitioner’s written advice for purposes of making a good faith determination pursuant to the Proposed Regulations and, if appropriate, the length of the time limit;

- Whether Rev. Proc. 92-94, which sets forth a procedure for making a good faith determination based on the affidavit of a foreign organization, should be revised to take into account recent changes to the public support test used to determine public charity status; and

- Whether the ability of a private foundation to base a good faith determination on the affidavit of a foreign organization should be retained, and if so, whether the use of affidavits should be restricted.

These comments respond to the above questions and include additional recommendations regarding issues that arise regularly in the equivalency determination process. Of primary importance is the revision of Rev. Proc. 92-94 both to reflect changes to the law since Rev. Proc. 92-94 was issued and to address specific provisions in Rev. Proc. 92-94 that have made it difficult for many private foundations to be comfortable that an equivalency determination made in connection with a grant to a foreign organization would be viewed favorably by the Internal Revenue Service (the “Service”) and should be relied upon by them for purposes of the grant. The following is a summary of our recommendations.

1. With respect to whether it is appropriate to limit the time during which a private foundation is permitted to rely upon a qualified tax practitioner’s written advice,
in connection with equivalency determinations that do not involve a foreign organization’s sources of financial support, we recommend that private foundations be permitted to rely on the written advice of a qualified tax practitioner for a period of five tax years starting on the first day of the grantee’s tax year immediately following the tax year in which the written advice was received, provided that at any time after three years from such date, the private foundation may rely on the written advice only if it (a) has received a certificate as described below dated not less than one year before the date on which a payment will be made to the foreign organization and (b) has made a reasonable determination within such one-year period that there has been no change in U.S. law that would affect the determination. The certificate would be required to be signed by an officer of the grantee and state that the facts and the relevant law on which the determination was based have not changed in any material respect since the equivalency determination was made. In addition, we recommend that private foundations be permitted to rely on the written advice of a qualified tax practitioner in connection with equivalency determinations that involve a foreign organization’s sources of financial support for a period of two years after the end of the last year for which the foreign organization provided data to demonstrate its public support. For both types of equivalency determinations, a private foundation is permitted to rely on the written advice of a qualified tax practitioner only if the private foundation does not know or have reason to know that the facts underlying the written advice have changed or that there has been a significant change in the relevant law of the foreign country.

2. With respect to public support calculations for “currently qualified” affidavits as set forth in Rev. Proc. 92-94, in light of the updated Treasury Regulations that changed the calculation period for public support for purposes of section 170(b)(1)(A)(vi), we recommend that the Service revise Rev. Proc. 92-94 to define “currently qualified” in light of the current five-year calculation period for public support. Specifically, Rev. Proc. 92-94 should confirm that grantmakers can rely on an affidavit of the grantee that establishes section 501(c)(3) and public charity-equivalent status for the most recently completed fiscal year.

3. With respect to the applicability of Rev. Proc. 92-94 to sponsoring organizations of donor-advised funds, we recommend that the Service, pending the issuance of regulations relating to donor-advised funds, amplify Rev. Proc. 92-94 to permit sponsoring organizations of donor-advised funds to make equivalency determinations pursuant to Rev. Proc. 92-94 when making grants to foreign organizations.

4. With respect to public support calculations for recently established foreign organizations, in light of the elimination of the advance ruling period, we recommend that the Service update Rev. Proc. 92-94 to provide that an affidavit is currently qualified if a foreign organization in the first five years of its existence reasonably can be expected to qualify as publicly supported.
5. With respect to public support calculations where a foreign organization has received support from a foreign government, international organization or foreign organization, we recommend that the Service amplify Rev. Proc. 92-94 expressly to confirm that, for purposes of the public support calculation in connection with a currently qualified affidavit, support from a foreign government or governmental unit, a U.S. government-designated international organization, or a foreign organization described in section 509(a)(1) may be counted in full.

6. With respect to the new requirements applicable to tax-exempt hospitals under section 501(r), we recommend that the Service update Rev. Proc. 92-94 to clarify that grantors need not evaluate foreign hospitals for compliance with section 501(r).

7. With respect to Rev. Proc. 92-94’s requirement that foreign schools demonstrate compliance with the provisions of Rev. Proc. 75-50\(^4\) that set forth guidelines and recordkeeping requirements for determining if a private school has a racially nondiscriminatory policy as to students, we recommend that the Service update Rev. Proc. 92-94 to clarify that foreign schools must attest that they do not discriminate on the basis of race, color or national and ethnic origin, but are exempt from the specific requirements of Rev. Proc. 75-50.

8. With respect to whether the ability of a private foundation to base a good faith determination on the affidavit of a foreign organization should be retained, and if so, whether the use of affidavits should be restricted, we recommend that the Treasury Regulations continue to permit private foundations to base good faith determinations on the affidavit of a foreign organization, with no restrictions on the use of such affidavits provided that private foundations rely on such affidavits in good faith.

These Comments provide suggestions to promote charitable grantmaking and decrease administrative costs by providing private foundations and sponsoring organizations of donor-advised funds greater clarity about standards applicable to equivalency determinations. These Comments undertake to balance the policy considerations of avoiding a diversion from charitable uses of assets for which a charitable contribution deduction has been allowed with those of encouraging world-wide philanthropic activities by U.S. foundations and sponsoring organizations. Inherent in this balancing is a consideration of practical and cost-justified due diligence by grantor organizations and administratively practical compliance procedures for the Service.

1. **The Timeframe during which Private Foundations May Rely on Written Advice.**

Treasury Regulations section 53.4942(a)-3(a)(6), as revised by the Proposed Regulations, provides that a distribution to a foreign organization which has not received a ruling or determination letter that it is an organization described in section 509(a)(1), (a)(2) or (a)(3) or section 4942(j)(3), will be treated as a distribution to an organization described in section 509(a)(1), (a)(2) or (a)(3) (i.e., a public charity) (other than certain supporting organizations described in sections 4942(g)(4)(A)(i) or (g)(4)(A)(ii)) or section 4942(j)(3) (i.e., a private operating foundation) if the distributing foundation has made a good faith determination that the foreign donee organization is an organization described in section 509(a)(1), (a)(2) or (a)(3) (other than certain supporting organizations described in sections 4942(g)(4)(A)(i) or (g)(4)(A)(ii)) or section 4942(j)(3). A good faith determination ordinarily will be considered as made if the determination is based on either an affidavit of the foreign donee organization or written advice from a qualified tax practitioner that the foreign donee organization is an organization described in section 509(a)(1), (a)(2) or (a)(3) (other than certain supporting organizations described in sections 4942(g)(4)(A)(i) or (g)(4)(A)(ii)) or section 4942(j)(3).

The Treasury Regulations do not specify the timeframe during which private foundation grantors and public charities, such as sponsoring organizations of donor advised funds, that follow the same rules may rely on the written advice of a qualified tax practitioner in making a good faith determination that a foreign organization is the equivalent of a U.S. public charity or private operating foundation.

Written advice obtained in connection with a good faith determination that a foreign organization is the equivalent of a U.S. public charity, where the determination includes consideration of a foreign organization’s percentage of public support, includes a natural expiration date. This is because the public support test used to determine if an organization is described in section 170(b)(1)(A)(vi), and therefore described in section 509(a)(1), considers an organization’s financial support over a set number of years and provides that an organization is considered publicly supported only during certain, specific years.5

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In late 2008, the Service issued temporary regulations that, among other things, updated the time period for the calculation of public support for purposes of determining whether an organization is a public charity under section 170(b)(1)(A)(vi). These regulations, with a few modifications, became final on September 8, 2011 (the “Updated Regulations”). The Updated Regulations instituted a new calculation period of five years for organizations to measure public support; the prior test calculated public support on a four-year rolling basis.\(^6\) Pursuant to the Updated Regulations, an organization that fails a public support test for two consecutive taxable years will be treated as a private foundation as of the beginning of the second year of failure only for purposes of sections 507 (termination of private foundation status), 4940 (excise tax on investment income), and 6033 (requirement to file Form 990-PF). For all other purposes, the organization will be treated as a public charity until the first day of the third consecutive taxable year.\(^7\) Thus, for example, if an organization fails to meet the public support test for the periods 2008-2012 and 2009-2013, it will be treated as a public charity for all chapter 42 purposes other than the excise tax on investment income until the beginning of 2014.

Foreign organizations must demonstrate that they meet the definition of “publicly supported” set forth in the Treasury Regulations unless the foreign organization is the equivalent of a different type of organization under section 170(b)(1)(A), such as an educational organization, a church or convention of churches or a hospital or medical research organization. In such cases, the written advice obtained by a grantor private foundation typically will include an analysis of the foreign organization’s qualification as a publicly supported organization. Because this analysis is based on financial information provided by the foreign organization, and because public support is calculated on a rolling basis,\(^8\) the written advice will only be able to address a foreign organization’s publicly supported status for a set period of time.

Written advice obtained in connection with a good faith determination that a foreign organization is the equivalent of a U.S. public charity where the determination does not rely on the foreign organization’s sources of financial support does not include such an obvious expiration date. For example, written advice from a qualified tax practitioner that a foreign organization is the equivalent of a U.S. educational organization, and therefore the equivalent of an organization described in sections 509(a)(1) and 170(b)(1)(A)(ii), would not require an analysis of the foreign organization’s financial support on a continuing basis.

**Recommendation:** Permit private foundations to rely on the written advice of a qualified tax practitioner in connection with equivalency determinations that do not involve a foreign organization’s sources of financial support for a period of five tax years starting on the first day of the grantee’s tax year immediately following the tax year in which the written advice was received, provided that at any time after three years from such date, the private foundation may rely on the written advice only if it (a) has received a certificate as described below dated not less than one year before the date on which a payment will be made to the foreign organization and (b) has made a reasonable determination within such one-year period that there has been no change in U.S. law that

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\(^7\) Treas. Reg. § 1.170A-9(f)(4)(vii).

\(^8\) Id.
would affect the determination. The annual certificate would be required to be signed by an officer of the grantee and state that the facts and the relevant law on which the determination was based have not changed in any material respect since the equivalency determination was made. In addition, permit private foundations to rely on the written advice of a qualified tax practitioner in connection with equivalency determinations that involve a foreign organization’s sources of financial support for a period of two years after the end of the last year for which the foreign organization provided data to demonstrate its public support. For both types of equivalency determinations, a private foundation is permitted to rely on the written advice of a qualified tax practitioner only if the private foundation does not know or have reason to know that the facts underlying the written advice have changed or that there has been a significant change in the relevant law of the foreign country.

Requiring private foundations to receive updated written advice every five tax years (for equivalency determinations that do not rely on a foreign organization’s sources of financial support), with a current certificate from the grantee and an updated determination by the private foundation as described above after three years, ensures that private foundations regularly review the continued equivalency of their foreign grantee organizations without imposing excessive costs to update the written advice on private foundations. The recommended time frame of five years is intended to balance the Service’s obligations of promoting compliance with the Code’s restrictions on the use of private foundation assets and the interests of the private foundation community in avoiding unnecessary costs in international grantmaking and added burdens on foreign grantees.

For equivalency determinations relying on a foreign organization’s sources of financial support, permitting reliance for a period of two years after the end of the last tax year for which the foreign organization provided data to demonstrate its public support is consistent with the provision in the Updated Regulations providing that an organization that has failed a public support test for two consecutive years will continue to be treated as a public charity for all chapter 42 purposes other than section 4940 until the beginning of the third successive year. For example, a foreign organization with a calendar year accounting period and providing financial data demonstrating its compliance with the requirements for public charity status in 2012 typically would include financial data from 2007-2011. Prior to finalization in September 2011, the regulations defining public support indicated that passing a public support test for the 2007-2011 period would be sufficient to qualify the organization as a charity only through the end of 2012, resulting in a reliance period that might in some cases be only months or days.

The final Updated Regulations indicate that, even if an organization that met a public support test for 2007-2011 then fails to meet a public support test for 2008-2012, for all chapter 42 purposes other than the excise tax on investment income, the organization continues to be considered a public charity until the end of 2013. Applying that principle, a 2012 equivalency determination based on financial data from 2007-2011 is sufficient to demonstrate that a public charity will continue to be considered a public charity for purposes of sections 4942 and 4945 until the end of 2013, resulting in the expected one to two-year period of reliance. In addition, this recommended reliance period comports with our recommendation for amplifying Rev. Proc. 92-94, below, and ensures that private foundations, after providing foreign organizations with
reasonable time during which to prepare their financial statements, re-confirm the publicly supported status of the foreign organizations.

In both cases, private foundations should not be permitted to continue to rely on the written advice of a qualified tax practitioner if the private foundation knows or has reason to know that the facts or relevant law underlying the written advice have changed. That the Proposed Regulations require private foundations to meet the requirements of Treasury Regulations section 1.6664-4(c)(1) in relying on such written advice provides additional certainty that private foundations using written advice in connection with good faith determinations will take all of the relevant facts and circumstances into account before relying on the advice.

2. **Recommended Revisions and Amplifications of Rev. Proc. 92-94.**

   a. **Rev. Proc. 92-94 and Changes to the Public Support Test.**

   Rev. Proc. 92-94 provides that a “currently qualified” affidavit from a foreign organization may be relied on in making an equivalency determination for both the section 4942 qualifying distribution requirement and the section 4945 expenditure responsibility requirement. An affidavit will be considered to be “currently qualified” as long as the facts it contains are “up to date.” Rev. Proc. 92-94 bases its discussion of whether an affidavit is “currently qualified” on the prior Treasury Regulations and refers to the now-outdated calculation period of four years to measure public support set forth in those regulations. As explained above, the Updated Regulations instituted a new calculation period of five years for organizations to measure public support.

   Pursuant to some passages in Rev. Proc. 92-94, an affidavit is “currently qualified” in a particular year if it includes four years of financial information ending in either of the preceding two tax years. Other passages require enough financial data to demonstrate that the relevant financial test is met. In light of the Updated Regulations, these latter passages of Rev. Proc. 92-94 imply that an affidavit claiming section 509(a)(1) or 509(a)(2) status can be “currently qualified” only if it includes financial data from the five-year period ending with the current tax year or immediately preceding tax year. Understandably, this can make obtaining a “currently qualified” affidavit difficult.

   A foreign organization will not be able to provide financial information for its current tax year and, depending on the timing of the request for an affidavit, may not be able to provide

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10 Id. § 4.02.
13 See, e.g., Rev. Proc. 92-94, § 4.05.
financial information for its immediately preceding tax year.\textsuperscript{15} This could delay materially the issuance of a grant to a qualified charitable organization. In addition, it could require that grantors that obtain an affidavit late in the tax year of a foreign organization obtain another affidavit to make a follow-up grant to the same foreign organization only a few months later.

Under the current public support test, Rev. Proc. 92-94 indicates that a U.S. grantor would have to wait until the foreign organization’s financial statements for the preceding tax year are complete to verify that the foreign organization passed the public support test for the preceding tax year and, therefore, qualifies as publicly supported for the current tax year. This could materially delay the U.S. grantor’s ability to provide needed funding to a foreign organization. Such a result is inconsistent with the long-standing policy established in the Code and guidance from the Service that supports and facilitates the American tradition of engaging in international philanthropy.

**Recommendation:** Amplify Rev. Proc. 92-94 to define a “currently qualified” affidavit in light of the current five-year calculation period for public support and to confirm that grantmakers can rely on an affidavit of the grantee that establishes section 501(c)(3) and public charity-equivalent status for the most recently completed fiscal year.

For example, for a foreign organization operating on a calendar year basis, if an affidavit executed by the foreign organization in 2013 established that the organization was publicly supported for tax years 2011 and 2012 using financial data from tax years 2007-2011, the clarification to Rev. Proc. 92-94 would provide that the affidavit remains currently qualified through 2013. This provides a necessary safe harbor during which the organization may continue to receive grant funds while it prepares its financial statements to demonstrate that it met the public support percentage for the five-year period ending in 2012 and continues to be considered publicly supported for 2013.

b. **Application of Rev. Proc. 92-94 to Sponsoring Organizations.**

Rev. Proc. 92-94, by its terms, applies to private foundations making grants to foreign organizations. The Pension Protection Act of 2006 (the “PPA”)\textsuperscript{16} amended the Code by adding new section 4966,\textsuperscript{17} under which distributions from a donor-advised fund to any organization other than an organization described in section 170(b)(1)(A) are taxable expenditures.\textsuperscript{18} A distribution to an organization other than an organization described in section 170(b)(1)(A) will not be a taxable expenditure if the distribution is for purposes specified in section 170(c)(2)(B) and the sponsoring organization of the donor-advised fund exercises expenditure responsibility over the grant.\textsuperscript{19} Therefore, a sponsoring organization must exercise expenditure responsibility

\textsuperscript{15} As in the United States, many foreign organizations will retain auditors to provide audited financial reports for the just-completed tax year. Completion of an audit can take several months.


\textsuperscript{17} Section 4966 provides a definition of “donor-advised funds,” and also defines “sponsoring organization” as any organization that maintains one or more donor-advised funds. See I.R.C. § 4966(d)(1)-(2).

\textsuperscript{18} See I.R.C. § 4966(c).

\textsuperscript{19} See I.R.C. § 4966(c).
in connection with donor-advised fund grants to foreign organizations in order to avoid a possible excise tax.

However, the Joint Committee on Taxation (the “JCT”), in its technical explanation of the PPA (the “Technical Explanation”), noted that it expected that regulations similar to Treasury Regulations section 53.4945-5(a)(5), which sets forth the procedure for making equivalency determinations, would apply to sponsoring organizations. Since the PPA’s passage, neither the Treasury nor the Service has issued guidance with respect to equivalency determinations by sponsoring organizations of donor-advised funds in connection with potential grants to foreign organizations. Managers of sponsoring organizations have lacked guidance on whether they may utilize the procedures of Rev. Proc. 92-94 when considering grants to foreign organizations, as suggested by the Technical Explanation, or whether they instead are required to exercise expenditure responsibility in connection with all grants to foreign organizations.

**Recommendation:** Amplify Rev. Proc. 92-94 to permit sponsoring organizations of donor-advised funds to make equivalency determinations pursuant to Rev. Proc. 92-94 when making grants to foreign organizations.

With the number of donor-advised fund account-holders exceeding 150,000, it is important that sponsoring organizations have clear guidance as to how to interpret and apply the new rules enacted by the PPA, pending issuance of regulations similar to Treasury Regulations section 53.4945-5(a)(5).

c. **Rev. Proc. 92-94 and Changes to the Advance Ruling Period.**

The Updated Regulations also altered the calculation period for organizations attempting to qualify as publicly supported and eliminated the “advance ruling period” previously used to determine whether an organization granted tax-exempt status would qualify as a public charity as opposed to a private foundation. In place of the advance ruling period, the Updated Regulations provide that an organization that establishes to the Service that it reasonably can be expected to qualify as a public charity will be considered a public charity for the first five years of its existence, and will be required to establish that it is a public charity beginning with its sixth tax year, or else be subject to the regulations and excise taxes applicable to private foundations. Under Rev. Proc. 92-94, newly established foreign organizations will not be able to provide currently qualified affidavits because they will not be able to provide sufficient financial data, even if they reasonably can be expected to qualify as a publicly supported organization.

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20 See Staff of the Joint Committee on Taxation, 109th Cong., “Technical Explanation of H.R. 4, the ‘Pension Protection Act of 2006,’ as passed by the House on July 28, 2006 and as considered by the Senate on August 3, 2006,” at 349, note 526.


22 For the remainder of these Comments, we refer to “private foundations” when discussing organizations making grants using the procedures set forth in Rev. Proc. 92-94. However, the reasoning set forth in the remainder of these Comments applies to sponsoring organizations of donor-advised funds as well.

23 See Treas. Reg. § 1.509(a)-3(d)(1).

Recommendation: Update Rev. Proc. 92-94 to provide that an affidavit is currently qualified if a foreign organization in the first five years of its existence reasonably can be expected to qualify as publicly supported.

The Updated Regulations provide general guidelines for when an organization reasonably can be expected to qualify as publicly supported.\(^{25}\) We recommend that Rev. Proc. 92-94 be amplified expressly to permit private foundations to consider these factors in making a determination pursuant to a currently qualified affidavit that a foreign organization reasonably can be expected to qualify as publicly supported. Although this is a subjective standard, it is consistent with the current practice of the Service for U.S. charitable organizations.


In order to demonstrate to the Service that it is publicly supported and thus entitled to exemption from federal income taxation as a public charity as opposed to a private foundation, a U.S. charitable organization must provide financial data showing that it receives a substantial amount of support from the government or governmental units or from the general public.\(^{26}\) When calculating public support, a U.S. charitable organization may include in the numerator of its public support fraction only two percent of support received from individuals, trusts or corporations, but may include in full contributions it receives from the government or governmental units.\(^{27}\) Therefore, U.S. charitable organizations receiving substantial contributions from the government or government entities may qualify as publicly supported based solely on the contributions received from the government or government entities.

Rev. Proc. 92-94 provides procedures for calculating whether a foreign organization qualifies as publicly supported under sections 509(a)(1), (2) or (3). However, Rev. Proc. 92-94 does not address whether, in making these calculations, support from foreign organizations – specifically, (i) foreign governments, (ii) international organizations designated by executive order under 22 United States Code section 288, and (iii) foreign organizations that are equivalent to \textit{per se}\(^{28}\) and publicly supported charities as described in section 509(a)(1) – counts as limited or unlimited support for purposes of the public support test.\(^{29}\) As discussed in the June 10, 2009 Report of Recommendations of the Advisory Committee on Tax Exempt and Government Entities (the “ACT Report”), the confusion with respect to this issue is long-standing.\(^{30}\)


\(^{28}\) Certain organizations are classified as public charities \textit{per se}, regardless of their sources of support. These include churches, certain schools, hospitals and other medical organizations, certain organizations providing assistance to colleges and universities, and governmental units.

\(^{29}\) Limited support is support that is subject to the two percent limitation of section 509(a)(1). Unlimited support is support that is not subject to that limitation.

Recommendation: Amplify Rev. Proc. 92-94 expressly to confirm that, for purposes of the public support calculation in connection with a currently qualified affidavit, support from a foreign government or governmental unit, a U.S. government-designated international organization, or a foreign organization described in section 509(a)(1) may be counted in full.

Many foreign organizations receive substantial government support as well as support from international organizations and other foreign organizations. We recommend that the Service amplify Rev. Proc. 92-94 to confirm that, consistent with the approach in the Treasury Regulations that “foreign organizations are to be treated the same as U.S. organizations described in Code section 170(b)(1)(A) for purposes of Code section 509(a),” support from foreign governments and foreign governmental units, U.S. government-designated international organizations, and foreign organizations described in section 509(a)(1) are included in full for purposes of the public support test.

e. Rev. Proc. 92-94 and Section 501(r).

In March 2010, Congress enacted the Patient Protection and Affordable Care Act, which added to the Code new section 501(r). Section 501(r) applies to hospitals that are exempt from federal income taxation under section 501(c)(3) and imposes several operational requirements that tax-exempt hospitals must meet in order to retain tax-exempt status. A hospital organization must satisfy the requirements of section 501(r) separately with respect to each hospital facility it operates. Pursuant to proposed regulations published on June 26, 2012, for purposes of the section 501(r) requirements, the term “hospital facility” does not include a facility that is located outside the United States. Taxpayers are permitted to rely on the proposed regulations until final or temporary regulations are issued.

Recommendation: Update Rev. Proc. 92-94 to clarify that grantors need not evaluate foreign hospitals for compliance with section 501(r).

Consistent with the approach in the proposed regulations under section 501(r), we recommend that the Service amplify Rev. Proc. 92-94 to confirm that grantors need not measure a foreign hospital’s compliance with new section 501(r) in connection with making a determination that the foreign hospital is the equivalent of a U.S. public charity.


In the case of a foreign organization that is a school described in section 170(b)(1)(A)(ii), Rev. Proc. 92-94 requires that a currently qualified affidavit contain a statement that the foreign school has adopted and operates pursuant to a racially nondiscriminatory policy as to students, and requires that the affidavit explain any basis for the grantee school’s failure to comply with

one or more of the provisions of Rev. Proc. 75-50. That revenue procedure sets forth requirements for compliance with Rev. Rul. 71-447.\(^{33}\)

Rev. Rul. 71-447 provides that a school that otherwise meets the requirements of section 501(c)(3) will not qualify as an organization that is exempt from U.S. federal income taxation under section 501(c)(3) unless it has implemented a racially nondiscriminatory policy as to students.

### i. The Requirements of Rev. Proc. 75-50.

To comply with Rev. Proc. 75-50, a school must include a statement in its charter, by-laws or other governing instrument, or resolution of its governing body, that it has a racially nondiscriminatory policy as to students and does not discriminate against applicants and students on the basis of race, color, and national or ethnic origin. The school also must include a statement of its racially nondiscriminatory policy in all brochures and catalogues dealing with student admission, programs and scholarships, and include reference to its racially nondiscriminatory policy in other written advertising that it uses as a means of informing prospective students of its programs.

With respect to publicity, the school must make its racially nondiscriminatory policy known to all segments of the general community served by the school by either (i) publishing a notice of the policy in a newspaper of general circulation that serves all racial segments of the community, or (ii) using broadcast media to publicize the policy if this use makes the policy known to all segments of the general community the school serves. If the school cannot or does not comply with these requirements, it must qualify for one of the exceptions set forth in Rev. Proc. 75-50.

(a) Applicable Exception.

If a school customarily (i) draws a substantial percentage of its students nationwide or worldwide, (ii) follows a racially nondiscriminatory policy as to students, and (iii) includes its racially nondiscriminatory policy in all required material, the school will be exempt from Rev. Proc. 75-50’s requirement that it publicize its racially non-discriminatory policy via newspaper or broadcast media if it also demonstrates (x) that it currently enrolls students of racial minority groups in meaningful numbers, or (y) if that is not the case, that its promotional activities and recruiting efforts in each geographic area were reasonably designed to inform students of all racial segments in the general communities within the area of the availability of the school. Whether a school qualifies for this exception will be determined on the basis of the facts and circumstances of each case.\(^{34}\)

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\(^{34}\) Rev. Proc. 75-50 sets forth two other exceptions, one of which refers to parochial schools and one of which refers to schools drawing students from a local community. As these exceptions are narrow and arise less frequently, these Comments do not discuss them in depth.
(b) Additional Requirements of Rev. Proc. 75-50.

A school also must be able to show that all of its programs and facilities are operated in a racially nondiscriminatory manner. All scholarship and other comparable benefits must be offered on a racially nondiscriminatory basis, and the availability of benefits must be known throughout the general community being served by the school and be referenced in the school’s publicity materials. Finally, an individual authorized to take official action on behalf of the school must certify annually under penalties of perjury on I.R.S. Form 5578 that, to the best of his or her knowledge and belief, the school has satisfied the applicable requirements of Rev. Proc. 75-50.


Both Rev. Rul. 71-447 and Rev. Proc. 75-50 by their terms apply only to private schools applying for exemption from U.S. federal income tax. Rev. Proc. 75-50, published in 1975, states the Service’s view that, at the time of publication, there was “a need for more specific guidelines to insure a uniform approach to the determination of whether a private school has a racially nondiscriminatory policy as to students.” GCM 37867 purports to apply the requirements of Rev. Proc. 75-50 to foreign public schools in addition to foreign private schools because “there is no guarantee” that foreign public schools will be required to operate under the principle of equal protection of the laws, as is required of U.S. public schools. This language implies that a public school in a foreign country, the constitution of which does provide for equal protection, may not be subject to the requirements of Rev. Proc. 75-50. However, Rev. Proc. 92-94 provides that a “currently qualified” affidavit must ask whether a school complies with Rev. Proc. 75-50.

The requirements of Rev. Proc. 75-50 were adopted in response to (i) skepticism of the representations made by U.S. private schools that they did not discriminate on the basis of race, and (ii) judicial dissatisfaction with the Service’s procedures that provided no effective means of disputing the schools’ representations. The provisions of Rev. Proc. 75-50 were designed to require schools to provide meaningful and objective information from which a determination could be made as to whether a school operated on a racially nondiscriminatory basis. The Service has recognized that situations may arise where foreign law or practice may render compliance with certain of the requirements illegal or impractical in a particular country. In these cases, compliance with the requirements may be excused, but only after a showing by the foreign school of a reasonable basis for noncompliance.

iii. Reasonable Basis for Noncompliance.

Specifically, GCM 37867 provides that if a foreign school can demonstrate a reasonable basis from which to conclude that compliance with one or more provisions of Rev. Proc. 75-50 would be illegal under foreign law or impractical under the circumstances, compliance may be
excused. For example, one foreign school analyzed in GCM 37867 stated that “the publication
requirements of Rev. Proc. 75-50 would be ‘so uncalled for and out of place in [its] society as to
be quite without meaning, and, in fact, would raise quite embarrassing questions as to [its]
judgments and motives.”’ In that situation, the school was recognized as exempt without having
to meet the Rev. Proc. 75-50 publication requirement. GCM 37867 also found a reasonable basis
to excuse a different foreign school from the record-keeping requirements of Rev. Proc. 75-50
where the school showed that compliance would require inquiries illegal under the foreign law
governing the school and would be impractical since the school’s nondiscriminatory purposes
were implemented by abstention from inquiry into race. In addition, GCM 37867 notes that
compliance with the publication of notice of nondiscrimination requirements may be impractical
where a school draws a substantial percentage of its students nationwide or worldwide.

iv. Compliance Problems under GCM 37867.

The requirements of Rev. Proc. 75-50 are substantial in volume and require the
continuous attention of schools to which the revenue procedure applies. These requirements can
be an obstacle to foreign schools that may receive grants from private foundations. For
example, foreign schools that are not often recipients of grants from U.S. organizations may not
have ready access to detailed records showing the race or ethnicity of students, particularly in
racially homogenous countries. The Service recognized these problems in the late 1970s. The
Chief Counsel’s Office issued GCM 36930 agreeing that “Rev. Proc. 75-50 was occasioned by a
unique domestic situation, and…in a great many instances an observance of all its detailed
procedural and technical requirements would be unduly burdensome for a foreign educational
institution when considered in relation to the comparatively small portion of total support such
an institution normally obtains from United States sources.”37 The Chief Counsel’s Office went
on to conclude in GCM 36930 that the private foundation in the fact pattern at hand could make
a good faith determination that the foreign school in question was a public charity, even though it
did not comply with the procedural or record-keeping requirements of Rev. Proc. 75-50.

However, GCM 37867 revoked GCM 36930, citing “sufficient authority” that foreign
schools should be subject to the requirements of Rev. Rul. 71-447 and Rev. Proc. 75-50. GCM
37867 also extended the application of Rev. Proc. 75-50 to foreign public schools, reasoning, as
noted above, that foreign public schools may not be required to operate under equal protection
laws, as they are in the United States. These conflicting interpretations leave private foundations
in uncertainty with respect to grants to foreign schools.

As the Chief Counsel’s Office noted in GCM 36930, the detailed requirements of Rev.
Proc. 75-50 are based on a “unique domestic situation,” which frustrated Congress and the courts
for years. As federal and state governments attempted to integrate schools, more and more white
families sent their children to private schools to defeat the purpose of integration. By putting
into place very specific nondiscriminatory policy requirements and threatening loss of tax-
exempt status as a result of noncompliance, the Service helped to move the country towards
greater integration in schools.

37 GCM 36930 (Nov. 24, 1976).
Although some foreign schools may provide in their governing documents or on their application materials that they do not discriminate on the basis of race or ethnicity, many historically will not have complied with the type of detailed recordkeeping and publication requirements crafted specifically to ensure that schools in the United States did not discriminate on the basis of race or ethnicity. In fact, and as discussed in GCM 37867, compliance with the terms of Rev. Proc. 75-50 may violate foreign laws. For example, in response to the collection of racial statistics by the Nazis in Germany during World War II, some countries (e.g., Germany and France) explicitly ban collection of such data. At the very least, and in our experience, many foreign schools find the requirements of GCM 37867 “so out of place and uncalled for in [their] society[ies] as to be without meaning.”

Private foundations therefore are presented with a difficult decision when attempting to make a grant to a foreign school. The school may very well represent on an affidavit that it operates pursuant to a racially nondiscriminatory policy and may represent that it complies with the terms of Rev. Proc. 75-50. However, in our experience with foreign schools, to-the-letter compliance with the requirements of Rev. Proc. 75-50 is the exception, not the rule. Generally, this is not due to any attempt to evade the requirements, but is due to a misunderstanding or lack of knowledge of Rev. Proc. 75-50’s specific terms.

**Recommendation: Update Rev. Proc. 92-94 to clarify that foreign schools must attest that they do not discriminate on the basis of race, color or national and ethnic origin, but are exempt from the specific requirements of Rev. Proc. 75-50.**

We recommend that the Service clarify Rev. Proc. 92-94 such that a currently qualified affidavit can include a statement that the foreign school operates pursuant to a racially nondiscriminatory policy – specifically, that it does not discriminate on the basis of race, color, and national or ethnic origin – instead of an attestation that the foreign school complies with Rev. Proc. 75-50.

Private foundations currently are funding projects at foreign schools all over the world. These foundations require clear guidance as to the Service’s expectations with respect to currently qualified affidavits for purposes of Rev. Proc. 92-94. The current lack of clarity, combined with the requirements placed on foreign schools by Rev. Proc. 92-94’s reference to Rev. Proc. 75-50, make issuing these grants difficult. Although a racially nondiscriminatory policy is an important consideration in making a good faith determination as to the public charity status of a foreign school, the myriad requirements of Rev. Proc. 75-50 are unusual and often confusing to school officials in foreign countries, and private foundations attempting to make grants to foreign schools can incur substantial legal bills as they must consult with counsel and attempt to analyze the content of the affidavits with respect to racially nondiscriminatory policies.

### 3. Reliance on the Affidavit of a Foreign Organization

As noted above, the Proposed Regulations and current law permit private foundations to base a good faith determination that a foreign organization is the equivalent of a U.S. public

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38 See GCM 37867 (Feb. 27, 1979).
charity on the affidavit of a foreign organization. Rev. Proc. 92-94, discussed in detail above, provides a procedure for private foundations to follow in making good faith determinations based on the affidavit of a foreign organization. The requirements of Rev. Proc. 92-94 are rigorous and include that a principal officer of the foreign organization attest to the affidavit and provide to the private foundation copies of the foreign organization’s charter, by-laws or other governing documents.

Even with the broadened base of practitioners from whom private foundations may seek written advice in connection with making a good faith determination as to a foreign organization’s equivalent status, the use of affidavits remains critical to private foundations. Obtaining written advice, even as opposed to obtaining an opinion of counsel, still imposes potentially substantial costs on private foundations, particularly those foundations that make grants to many foreign organizations or who make repeat grants to particular foreign organizations.

In our experience, private foundations comply with Rev. Proc. 92-94’s rigorous requirements for affidavits, which often means working closely with a foreign organization to ensure that the principal officer attesting to the affidavit understands exactly what is called for under the affidavit and what information the foreign organization must provide in connection with the affidavit. In situations where a good faith determination may be particularly complex, private foundations may seek the written advice of a qualified tax practitioner to provide additional comfort in connection with making a good faith determination as to a foreign organization’s status as the equivalent of a U.S. public charity. Even in such cases, however, we often see that written advice as to a foreign organization’s equivalency is based on the information provided to a private foundation in an affidavit that complies with Rev. Proc. 92-94.

**Recommendation: Do not restrict a private foundation’s ability to base a good faith determination on the affidavit of a foreign organization.**

We recommend that the Treasury Regulations continue to permit private foundations to base good faith determinations on the affidavits of foreign organizations. Current law, as revised by the Proposed Regulations, provides ample protection to ensure that private foundations properly investigate the status of foreign donee organizations and take care in making a good faith determination that any foreign organization is the equivalent of a U.S. public charity.

The procedures for currently qualified affidavits set forth in Rev. Proc. 92-94 require that affidavits include significant detail and specific accompanying documentation. These procedures ensure that private foundations have a clear picture of the organization and operation of the foreign organization before making a good faith determination based on the affidavit. In our experience, private foundations that rely on such affidavits do so with care and consideration. Restricting a private foundation’s ability to base good faith determinations on affidavits of foreign organizations will add significant costs for private foundation grantors and is likely to inappropriately discourage or inhibit foreign grantmaking.

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