Bloomberg BNA

Tax Management
International Journal™

Determining Foreign Charity Status

By Kimberly S. Blanchard, Esq.
Weil, Gotshal & Manges LLP
New York, New York

There is a drought in international tax developments these days, what with BEPS being old news and nothing going on, on the regulatory front, in Washington. The good news for those of us interested in the weird problems of foreign charities is that the Internal Revenue Service just released an update and rewrite of old Rev. Proc. 92-94. The new guidance is found in Rev. Proc. 2017-53. While this guidance is directed only to the procedures that must be followed by U.S. private foundations that wish to make grants to foreign charities, it is of relevance to the manner in which U.S. withholding agents must obtain certification of foreign charity status for purposes of withholding U.S. tax on payments to foreign charities.

THE REVENUE PROCEDURE

To understand what the revenue procedure is about, one has to step back and recall that a foreign organization described in §501(c)(3) is exempt from U.S. tax in the same way that a domestic charity is. Moreover, a foreign charity, like a domestic one, may be either a ''public charity'' or a ''private foundation.'' However, one difference between a domestic charity and a foreign one is that most domestic charities are required under §508 to secure a determination from the IRS as to their exempt status and their private foundation status, whereas most foreign charities are not. Foreign charities can thus be described in §501(c)(3), and may be public charities, even though they do not have an IRS determination letter to that effect.[1]

The other piece of information one needs to understand before evaluating the revenue procedure is that domestic private foundations are subject to a number of punitive excise taxes intended to ensure that they are operated for charitable purposes. At bottom, what this means is that domestic private foundations must give away most of their money, and must give their money away to charities that are qualifying public charities (not to other private foundations). In order to avoid an excise tax under §4942, a private foundation must make minimum ''qualifying distributions,'' defined generally as grants for exempt purposes made to public charities. Section 4945 also imposes an excise tax on ''taxable expenditures,'' which generally include grants to organizations other than public charities, unless strict expenditure responsibility rules are complied with by the private foundation.

Nothing in these rules requires that the grants be made to *domestic* public charities. And many U.S. private foundations make grants to foreign charities for the accomplishment of charitable goals. So, suppose that a U.S. private foundation wishes to make grants to a charity formed under foreign law. If that foreign charity has an IRS determination letter recognizing its exemption under §501(c)(3) and classifying it as a public charity, the granting organization needs to inquire no further. But in the great majority of cases, a foreign charity will not have an IRS determination letter, because it is not required to have one and because it would normally be a bad idea to get one.[2]

This is where the revenue procedure comes in. Rev. Proc. 2017-53, like its predecessor, provides instructions to U.S. private foundations that wish to make grants to foreign charities. It applies where the foreign charity does not have an IRS letter. In the absence of

[1] Under §4948(b), a foreign charity is required to get an IRS determination letter only if it is ''U.S. supported,'' which the IRS has interpreted as receiving more than 15% of its total counted support from U.S. sources.

All section references are to the Internal Revenue Code, as amended, or the Treasury regulations thereunder.

[2] *See* Blanchard, *When Must a Foreign Charity File a Form 990?* 45 Tax Mgmt. Int'l J. 553 (Sept. 9, 2016).

ISSN 0090-4600

such a letter, a U.S. private foundation wishing to make a qualifying grant to a foreign charity must determine (1) whether the foreign charity is in fact described in §501(c)(3), and (2) whether the foreign charity is publicly supported, i.e., a public charity. Rev. Proc. 2017-53 sets forth the rules that the U.S. private foundation must follow in order to make this determination, known as an ''equivalency determination.''

In practice, the revenue procedure is actually a guide for lawyers, not their private foundation clients. The private foundation must secure written advice form a qualified advisor as to the foreign charity's status, and that advisor will apply the rules of the revenue procedure in rendering that advice. This is made explicit in the revenue procedure itself, as well as the applicable regulations.[3] One reason that former Rev. Proc. 92-94 needed updating is that, prior to 2015, a foreign charity could generally self-certify (although in practice this was usually done on written advice from counsel). In 2015, the applicable regulations under the private foundation rules were changed so that the private foundation can rely on a foreign charity's status determination only if that determination is made by a ''qualified tax practitioner.''

THE WITHHOLDING REGULATIONS

Even if you don't practice in the grantmaking area, the revenue procedure is important, at least by analogy, in applying the §1441 withholding rules to payments made to foreign charities. Again — a foreign charity described in §501(c)(3) is exempt in the same way a domestic charity is, so is exempt from U.S. withholding tax, except upon its unrelated business income.[4]

The §1441 regulations provide their own type of ''equivalency determination'' for withholding agents to use in determining whether a payment is made to an exempt foreign charity. Those regulations, at Reg. §1.1441-9, require that the foreign charity provide the withholding agent with either an IRS determination letter or an opinion of U.S. counsel. The opinion requirement for ''unlettered'' foreign charities, which predated and foreshadowed the 2015 changes to the private foundation rules, was intended as a higher burden of proof than the old self-certification rules that applied under Rev. Proc. 92-94. A copy of the IRS letter or opinion must be attached to the foreign charity's Form W-8EXP.

The regulations require that a separate private foundation ''affidavit'' be attached to the Form W-8EXP, *even if the foreign charity has an IRS letter.* The instructions to the Form W-8EXP repeat this requirement, and cross-reference Rev. Proc. 92-94.

This is just error. Every IRS letter specifically determines the charity's status as a private foundation or public charity. There is thus no need for the foreign charity to attach a separate affidavit complying with the revenue procedure in order for the IRS to make that determination a second time. In any case, neither Rev. Proc. 92-94 nor new Rev. Proc. 2017-53 applies where the foreign charity has an IRS letter. Since the instructions' cross-reference now needs to be updated, the IRS should take this opportunity to eliminate this error in its regulations.

Even in the context of a foreign charity that does not have an IRS determination letter, the regulations require a private foundation affidavit in addition to an opinion of counsel. Requiring a private foundation affidavit in addition to an opinion of counsel is unnecessary and redundant. In rendering an opinion, counsel will invariably render an opinion on the private foundation question. There would be no point in getting an opinion that did not address the private foundation question, since it is needed both for withholding tax purposes (e.g., §1443(b)) and for granting purposes.

The statement in the preamble that this private foundation affidavit procedure somehow relieves a foreign charity ''from the obligation under the proposed regulations to provide an opinion of counsel regarding their non-private foundation status'' is thus based on a misunderstanding. The regulations under §1441 should simply require the opinion to cover the private foundation issue, as it invariably would.

These errors in the regulations and in Form W-8EXP affect not only the foreign charity's chapter 3 status but also the charity's chapter 4 (FATCA) status. Foreign charities are generally exempt from FATCA.[5] Reg. §1.1471-3(b) provides that a withholding agent must base its determination of the chapter 4 status of a payee on documentation that the withholding agent can reliably associate with such payment. Reg. §1.1471-3(c)(3)(iv) governs the use of a Form W-8EXP as such documentation. It provides that a Form W-8EXP is valid only if it contains, *inter alia*, ''the relevant certifications or documentation, and any other requirements indicated in the instructions to the form.'' Thus, a failure to comply with the form's unnecessary request for an affidavit could adversely affect both the charity's chapter 3 and its chapter 4 FATCA exemption. This appears to be so, even though a foreign charity's status as a private foundation or public charity is irrelevant under the Foreign Account Tax Compliance Act.

---

[3] Reg. §53.4942(a)-3(a)(6), §53.4945-5(a)(5).

[4] Section 1443(a) imposes withholding tax on the unrelated business taxable income of a foreign charity. In addition, §1443(b) imposes a 4% withholding (excise) tax on certain income of foreign private foundations.

[5] Reg. §1.1471-5(e)(5)(v), §1.1471-5(e)(5)(vi).

ISSN 0090-4600

As advisors to foreign charities know, the withholding tax and international rules applicable to foreign charities are, to put it charitably, a mess. While the drafters of the §1441 regulations seemed to recognize that there is such a thing as an ''unlettered'' foreign charity, they made incorrect assumptions as to how a foreign charity's status is documented. The publication of new Rev. Proc. 2017-53 is an opportune moment for the IRS to revise the §1441 regulations to correct these mistakes.

ISSN 0090-4600