

# HELPING UKRAINIANS – PRACTICAL U.S. FEDERAL TAX COMPLIANCE CONSIDERATIONS FOR FOREIGN GRANTMAKING IN A CHALLENGING PART OF THE WORLD

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## Helping Ukrainians – Practical U.S. Federal Tax Compliance Considerations for Foreign Grantmaking in a Challenging Part of the World

By Mike Batts, CPA

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Nonprofit organizations seeking to help the Ukrainian people with basic necessities of life are encountering logistical obstacles and are resorting to creative methods for delivering aid. Wiring money to a Ukrainian bank account, if even possible, may not help the recipient since many Ukrainians cannot buy food or goods with payment cards, and they may not currently have a way of accessing cash from their bank accounts.

Our firm has fielded multiple calls from client nonprofit organizations asking about U.S. federal tax compliance considerations associated with some of the creative delivery methods they are considering. As an example, one U.S. organization identified a nonprofit leader in a country neighboring Ukraine who was willing to receive a grant, convert the funds to cash, and hand-deliver cash or food and goods to needy Ukrainians.

Another nonprofit organization was seeking to help volunteers in a neighboring country buy an automobile to help Ukrainians evacuate war zones.

Of course, a U.S. nonprofit organization wishing to help Ukrainian people can make grants to a U.S. 501(c)(3) public charity that already has channels and methods for delivering aid to the people of Ukraine. Some U.S. nonprofits, however, wish to make grants directly to foreign organizations or individuals in the geographic area of Ukraine in order to engage more directly.

What are the requirements of U.S. federal income tax law with respect to nonprofit public charities (churches, schools, hospitals, and publicly supported charities) making grants to foreign organizations or individuals?

U.S. federal tax law is not highly specific with respect to documentation requirements for grants made by churches, schools, hospitals, and other 501(c)(3) public charities to foreign organizations and individuals. 501(c)(3) public charities are, however, subject to general requirements in federal tax law that they maintain adequate records to demonstrate that their activities and expenditures are in furtherance of their tax-exempt purposes. Specific rules do exist in federal tax law for 501(c)(3) private foundations. The requirements for private foundations include an “expenditure responsibility” rule, which contains specific documentation requirements to support grants to foreign organizations and individuals. While not clearly required by law, the IRS has effectively taken the position in examinations that public charities should follow the expenditure responsibility requirements applicable to private foundations when making foreign grants.

Below, I describe our standard recommendations for documentation, based on the expenditure responsibility rules, related to foreign grantmaking by U.S. public charities, and then I address **practical considerations**.<sup>1</sup>

### BMW Standard Recommendations for Documentation Related to Foreign Grantmaking by U.S. Public Charities

*The underpinning philosophy of these recommendations is that the IRS, in an examination, will want to see documentary evidence that funds your organization has sent to a foreign organization or individual were used in furtherance of your organization's tax-exempt purposes and not for*

<sup>[1]</sup> Neither the BMW standard recommendations nor the practical considerations described herein are intended to represent an exhaustive description of all tax or other compliance considerations that may be applicable to activities of the types addressed in this article. It is possible that other tax and legal compliance requirements may apply – both domestically and internationally. To address other such possible requirements, an organization's leaders should consult appropriately credentialed counsel in appropriate jurisdictions.

*any other purposes. While we cannot guarantee the effectiveness of these recommendations, we have not had any clients experience adverse IRS examination results (e.g., penalties) who substantially follow these recommendations.*

### **Pre-Grant Due Diligence**

The U.S. public charity should perform a pre-grant analysis of the legitimacy of the foreign organization/individual receiving the grant. The inquiry should give the U.S. public charity reasonable assurance that the foreign organization/individual will use the grant for the proper purposes. The inquiry should address such matters as the identity, past history, and experience of the individual grantee (or the foreign organization and its principals/managers) and include a review of any other information the U.S. public charity has concerning management, activities, and practices of the foreign organization/individual. The U.S. public charity should also verify that the individual grantee (or the foreign organization and its principals/managers) are not listed on the U.S. government's OFAC anti-terrorism watch list, which can be searched on the OFAC site.<sup>2</sup>

The U.S. public charity should retain proper documentation of its pre-grant inquiry and the results.

### **Grant Agreement**

Grants made by a U.S. public charity should be made subject to a written agreement drafted under the advice of legal counsel and signed by the foreign individual or an appropriate officer, director, or trustee of the foreign grantee organization. The agreement should include the following elements:

- The amount(s) to be granted
- The specific purpose(s) for which the grant funds will be used and where the grant activities are to be conducted
- A covenant by the grant recipient that it will not use the funds for lobbying, attempting to influence the outcome of any public election or voter registration drive, or any activity other than those specifically permitted by the grant agreement
- A covenant by the grant recipient that it will repay any portion of the grant not used for purposes specified in the agreement
- A covenant by the grant recipient that it will submit full and complete reports regularly (at least annually) concerning the manner in which the funds were spent and the progress made in accomplishing the purposes of the grant
- A covenant by the grant recipient that it will maintain records of funds received and expended and will make its books and records available to the U.S. public charity
- A requirement that the grant recipient use the funds for activities conducted entirely outside the U.S. and that none of the funds should be used for travel to the U.S. [Note that if the granting organization wishes to permit any portion of the funds to be used for travel to the United States, that aspect of the proposed arrangement should be carefully and specifically reviewed by special tax counsel to ensure compliance with applicable law.]
- A statement that the grantor organization has no moral or legal duty to provide the grant funds
- A statement that the grant recipient assumes full responsibility for the appropriate tax compliance filings in the relevant jurisdiction(s) in connection with the receipt of the granted funds
- A statement that the grant agreement shall not be construed as establishing an employment or agency relationship between the grantor organization and the recipient

<sup>2</sup> Source: <https://sanctionssearch.ofac.treas.gov/>

### **Periodic Reports from the Foreign Grantee**

The U.S. public charity should obtain reports at least annually from the grant recipient for the year in which the grant was made and for all subsequent years in which the grant funds are expended by the grant recipient. The reports should be furnished to the U.S. public charity within a reasonable time following the close of the grantee's fiscal year. The reports should be signed by the foreign individual (or an appropriate officer, director, or trustee of the foreign grantee organization) and should contain the following elements:

- Name and address of the foreign grantee organization/individual
- Date, amount(s), and purpose(s) of the grant
- Amounts expended by the foreign grantee organization/individual to date, together with reasonably specific information about how the funds were spent [Note that general financial statements from the grantee should only be considered adequate for this purpose if the U.S. public charity can reasonably derive from those statements how the granted funds were actually spent.]
- An affidavit stating that no portion of the funds has been diverted from their intended purpose(s)

### **Field Visits and Inspection of Books and Records**

The U.S. public charity should apply a risk-based approach to making periodic physical inspections of the activities of foreign grant recipients. When grant amounts are significant, and it is otherwise feasible and appropriate, the U.S. public charity should make periodic field visits to the foreign grantee's locations to evaluate the progress made in accomplishing the purposes of the grant. The observations made in the field visits should be well documented. Additionally, a grantmaking U.S. public charity should apply a risk-based approach to inspecting a grant recipient's books and records related to the use of grant funds. The amount of funds granted and the quality of accountability

reporting by the grant recipient are significant factors that should affect the decision as to whether to inspect books and records. Inspection results should be well documented.

### **Other Considerations**

The U.S. public charity organization should consult with legal counsel regarding any legal implications associated with the making of foreign grants, including (but not limited to) the specific terms of the grant agreement.

### **Practical Considerations**

In crisis or disaster scenarios, it can be tempting for nonprofit organizations to disregard compliance or internal control considerations in the heat of the moment due to the pressing need. It is understandable that nonprofit leaders would simply want to get aid to the people who need it and disregard the "paperwork."

In reality, a reasonable, risk-based approach to compliance and documentation is a better... and safer... approach, and it need not be unduly burdensome.

Let's assume that your organization is contemplating making a grant to an individual known to your organization who lives in a country neighboring Ukraine. The individual has agreed in an informal communication with you to use the funds to purchase food and to deliver the food to needy families in Ukraine. Let's take each of the standard recommendations described above and address how a risk-based approach might look.

### **Pre-Grant Due Diligence**

This one is pretty simple. Document why you have reason to believe that the individual can be trusted to use the grant funds in the manner intended. Document how you know the person, past experience with the person, references, etc. And make sure to search the federal OFAC anti-terrorism database to ensure that the person is not on the list.<sup>3</sup> Document your search results.

<sup>3</sup> Source: <https://sanctionssearch.ofac.treas.gov/>

[Note: It would be ideal to engage two unrelated people who would agree to work together in administering the grant funds for internal control purposes. That would establish better internal control by allowing the two people to have custody of the funds and to certify how the funds are used...as further addressed below. From a practical, risk-based perspective, if the grant funds are to one individual, it would be wise to limit the amount of the grant to a relatively small amount in relation to your organization's size. For example, for a large U.S. charity or church, \$25,000 might be a reasonable limit on the amount to entrust to a single individual. If two unrelated people can be engaged, the additional trust factor may allow your organization to make a significantly larger grant.]

*If the grant recipient were an organization (as opposed to an individual), you would document the same kinds of things with respect to the organization...and you would search the federal OFAC database for the name of the organization as well as its officers and board members.*

### **Grant Agreement**

Subject to advice from your legal counsel, if the grant amount is relatively small in relation to your organization's size (e.g., a grant of up to \$25,000 made by a large church), an email exchange with the grant recipient laying out the terms of the grant to which both parties agree can be adequate. As noted above, you want the agreement to state clearly how the grant funds are to be used and to state clearly that the funds will not be used for any other purpose.

Make sure that the grant agreement requires the grant recipient to provide a report back to you within a stated period of time (ideally about 30 days for this type of grant) detailing how the funds were applied. (See more on reporting to follow.)

### **Reports from the Foreign Grantee**

A risk-based approach can be applied to reporting by the grant recipient of the use of the grant funds. A report should detail how the funds were used and should include a certification that no funds

were used for any other purpose. As noted above, I would recommend that a report be required within 30 days of the grant date for a grant of this nature.

As for the amount of detail regarding the use of the funds, for a relatively small grant (e.g., a grant of up to \$25,000 made by a large organization), a specific description by the grant recipient of the use of the funds may be adequate. For a larger grant, a log or similar itemization would be more appropriate. And as noted previously, a grant to two unrelated individuals or to an organization creates a trust environment more suitable for larger grants.

[Note: Requiring the grant recipient to provide receipts for grocery purchases is not likely a reasonable requirement for such a grant. It is probably not realistic to expect a grant recipient to obtain receipts for buying groceries to help families in a war zone. And even if you were to have receipts for purchasing groceries in a war zone to help needy families, such receipts would not constitute evidence that the groceries were, in fact, used to help needy families.]

***Special compliance note:*** *It is wise to set a due date for a report from the grant recipient on the use of funds from one grant prior to releasing funds for a subsequent grant. If a grant recipient fails to provide you with a required report on the use of funds within the agreed-upon timeframe, you should not release additional grant funds to that grant recipient.*

### **Field Visits and Inspection of Books and Records**

For ordinary grants made to foreign organizations or individuals, we would recommend a risk-based approach to field visits or inspection of books and records. For example, if an organization makes a grant of \$1 million to a Haitian orphanage to add a wing to its buildings, it would be reasonable as the grant funds are disbursed in batches to go and physically observe that the building addition is indeed being constructed.

In my opinion, it is not reasonable to conduct field visits in a war zone for grants of the type addressed

in this article. Further, inspection of “books and records” may not be practical or feasible for the type of grant addressed in this article for reasons described above in the section entitled “Reports from the foreign grantee.”

## Conclusion

Delivering aid in crisis or disaster situations (not to mention war zones) can be challenging. The logistical challenges can make it tempting to disregard U.S. federal tax law compliance requirements or sound internal controls. Applying a practical, risk-based approach to grantmaking in such conditions can allow U.S. public charities to make grants in difficult situations while reasonably reducing the risk of noncompliance or misappropriation.

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