



# Funding Intermediaries – The Legal Dimension

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# Agenda

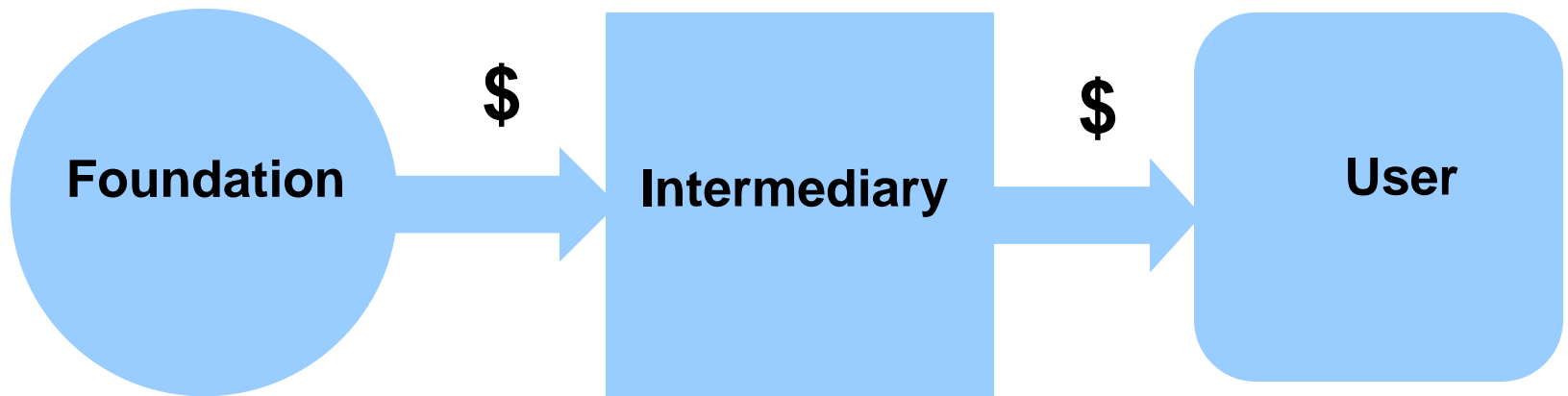
1. What is an intermediary?
2. When can an intermediary be helpful?
3. How can an intermediary be helpful?
4. What are the risks?

***Questions and comments - anytime***

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# What is an intermediary?

## “Intermediary”



# Scene 1

“Here’s a dollar. Use it wisely.”

*[Recipient accepts dollar and gives it away.]*

## Scene 2

“Here’s a dollar for the person sitting next to you.”  
*[Recipient accepts dollar and gives it away.]*

## Scene 3

“Here’s a dollar. I’m very interested in what the person sitting next to you would do with it. You could give it to him/her, or to someone else, or keep it.”

*[Recipient accepts dollar and gives it away.]*

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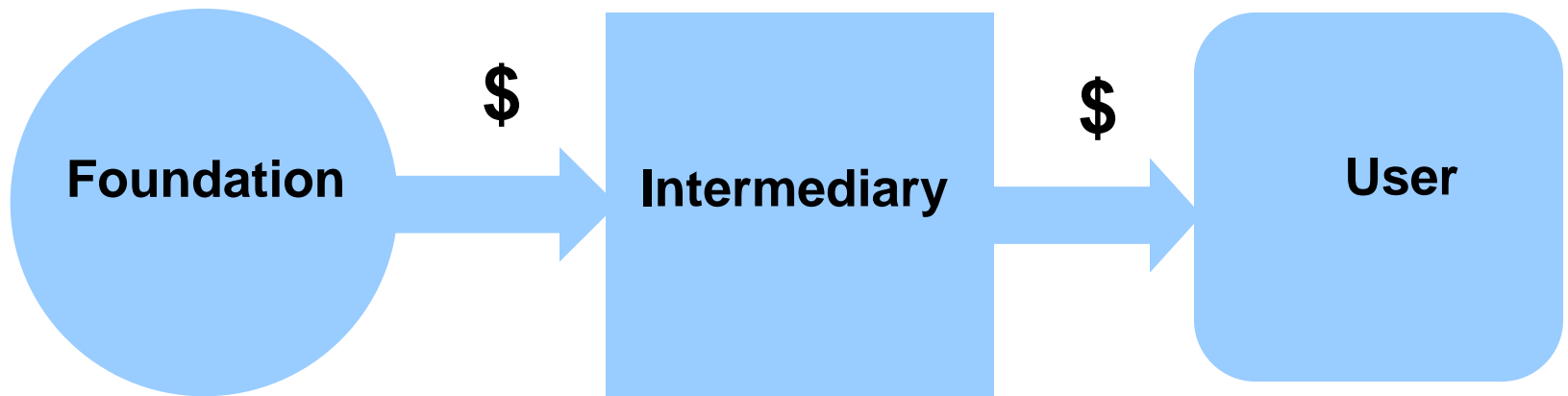
# When can an intermediary help?



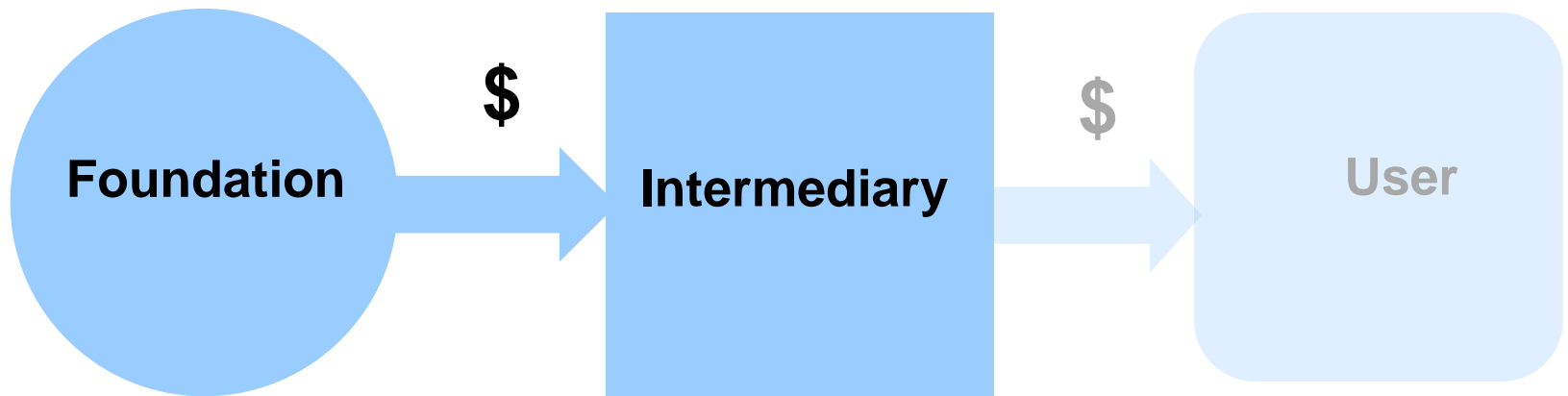
- **Grants that support...**
  - Non-501(c)(3) foreign NGOs
  - Start-up organizations
  - Grants to individuals for study, travel, etc.
  - Potential self-dealing situations
- **Managing 5% distribution requirement**
  - Controlled organizations
  - Timing
- **Reducing due diligence**

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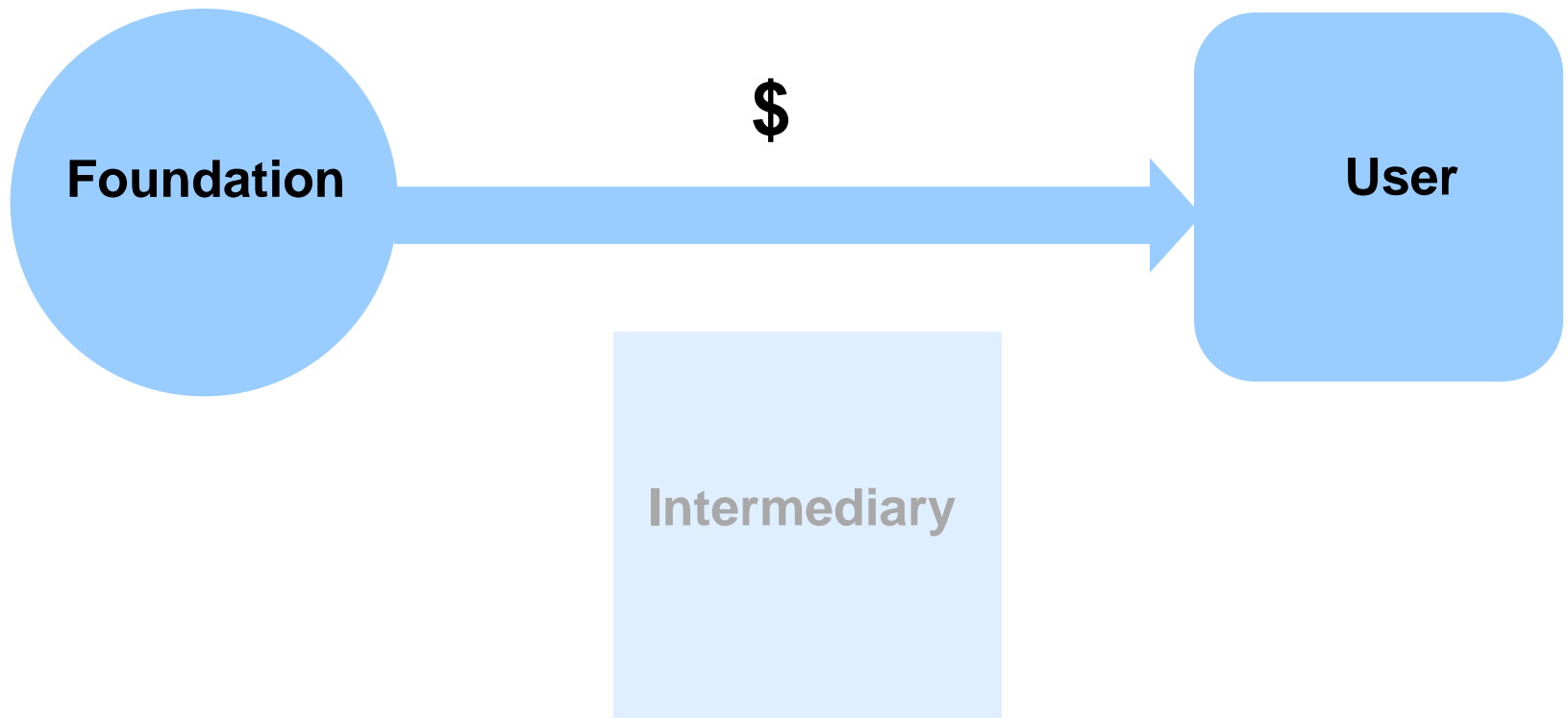
# How can an intermediary help?



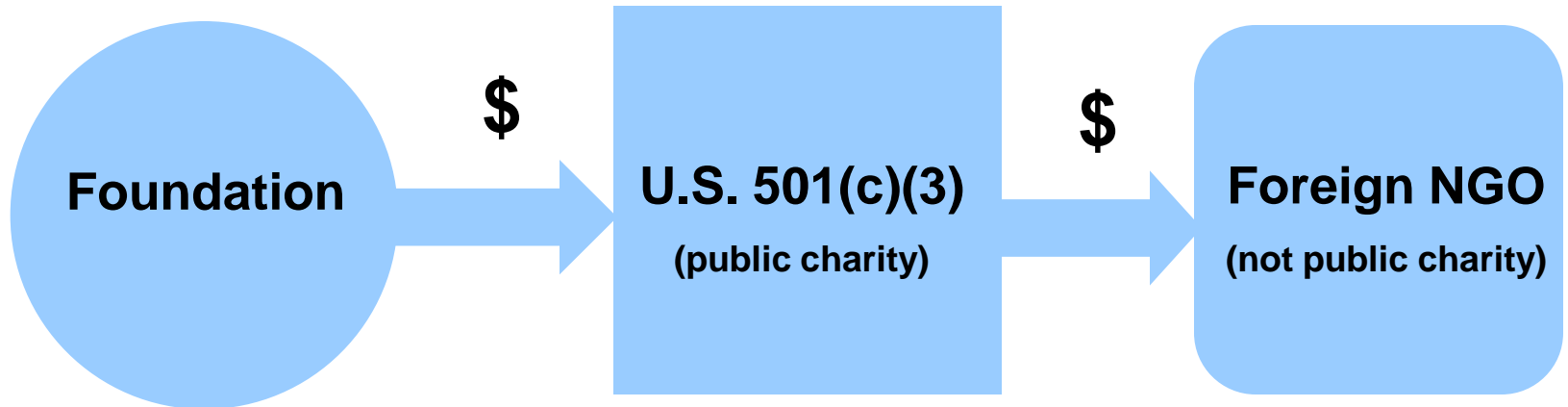
## Good:



**Bad:**



## Grants that support foreign NGOs



Internal Revenue Code section 4945 requires in effect that private foundations exercise expenditure responsibility or make an equivalency determination in connection with grants to organizations not recognized by the IRS as 501(c)(3) public charities.

Grants to foreign organizations also present the potential for diversion in support of terrorist activities and organizations.

- **Examples**
  - CAF America
  - Give2Asia
  - Global Greengrants Fund
  - Tides Foundation
  - United Way International
  - U.S. “friends of ...” organizations

- **Treasury Regulations:**

A grant by a private foundation to a grantee which the grantee organization uses to make payments to another organization (the secondary grantee) **shall not be regarded as a grant by the private foundation to the secondary grantee** if the foundation does not  **earmark** the use of the grant for any named secondary grantee and there does not exist an agreement, oral or written, whereby such grantor foundation may **cause the selection** of the secondary grantee by the organization to which it has given the grant.



- **Treasury Regulations, cont'd:**

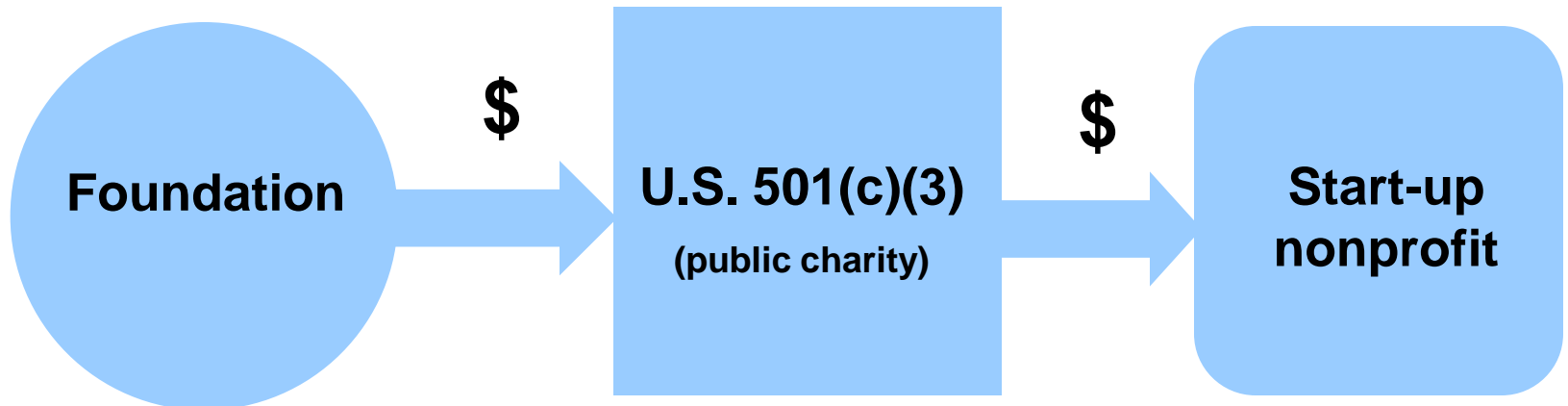
... a grant shall not be regarded as a grant by the foundation to the secondary grantee even though such foundation has **reason to believe** that certain organizations would derive benefits from such grants so long as the original grantee organization exercises **control, in fact**, over the selection process and actually makes the selection **completely independently** of the private foundation.

- **Documenting absence of earmarking**

- Grant agreement

“Grantee acknowledges that there does not exist any agreement, oral or written, whereby the Foundation may cause Grantee to select any particular subgrantee; that the Foundation has not earmarked the use of the Grant funds for any other organization or individual; that the Foundation will not direct or control the selection of any subgrantee, and that Grantee will make all such selections completely independently of the Foundation.”

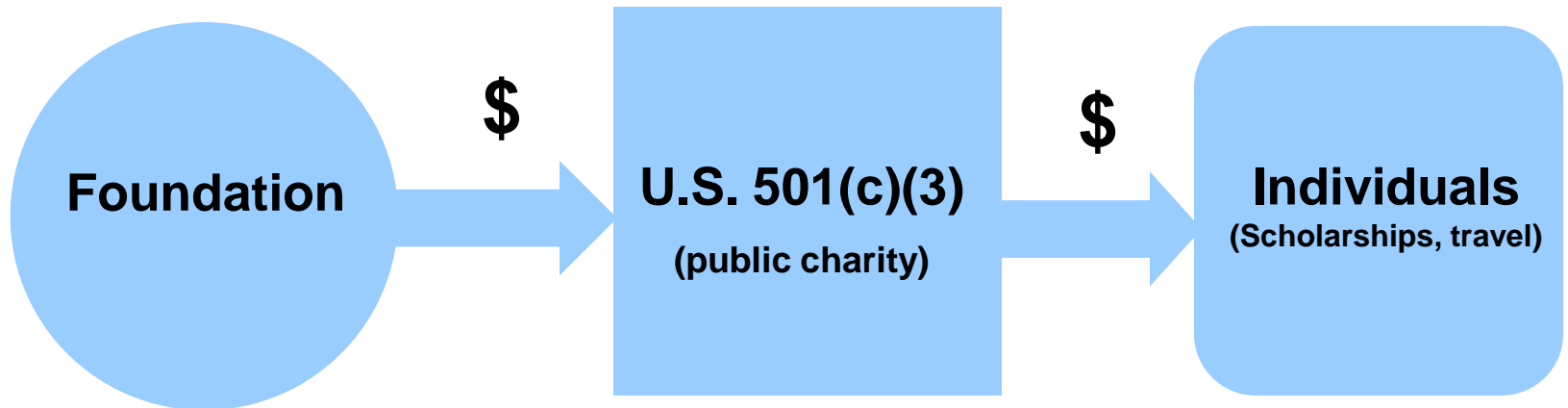
## Grants that support U.S. start-up organizations



Internal Revenue Code section 4945 requires in effect that private foundations exercise expenditure responsibility in connection with grants to organizations not recognized by the IRS as 501(c)(3) public charities.

- **Same analysis as grants for foreign NGOs:**
  - **Not earmarked**
  - **No agreement** allowing foundation to cause the selection
  - Grantee exercises **control in fact**
  - Grantee makes the selection **completely independently**

## Grants that support grants to individuals for study, travel, etc.



Internal Revenue Code section 4945 in effect requires that private foundation grants to individuals for travel, study, or other similar purposes be awarded pursuant to a procedure approved in advance by the IRS and meet certain additional requirements.

- **Treasury Regulations:**

A grant by a private foundation to an organization described in section 509(a)(1), (2), or (3), which the grantee organization uses to make payments to an individual for purposes described in section 4945(d)(3), shall not be regarded as a grant by the private foundation to the individual grantee... if the grant is made for a **project which is to be undertaken under the supervision** of the section 509(a)(1), (2), or (3) organization and such **grantee organization controls the selection of the individual grantee**. This subdivision shall apply regardless of whether the name of the individual grantee was first proposed by the private foundation, but only if there is **an objective manifestation of the section 509(a)(1), (2), or (3) organization's control over the selection process**, although the selection need *not* be made completely independently of the private foundation.

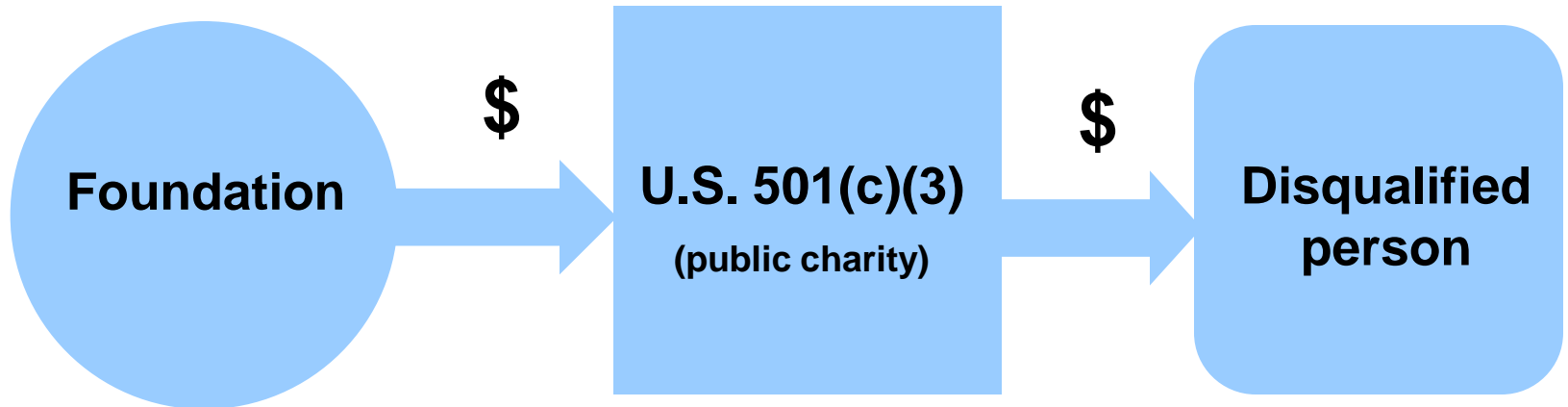
- **Treasury Regulations**

- *Factors from examples:*

- Grant terms *name* secondary grantee (“user”)
    - Grantee *must return* funds if not paid to named user
    - Foundation has *right to “renegotiate”* grant if funds not paid to named user
    - Foundation *suggests* particular user
    - Particular *user initiates* request to grantee

- None of these by itself is necessarily a problem.

## Grants that involve potential self-dealing situations (use with caution)



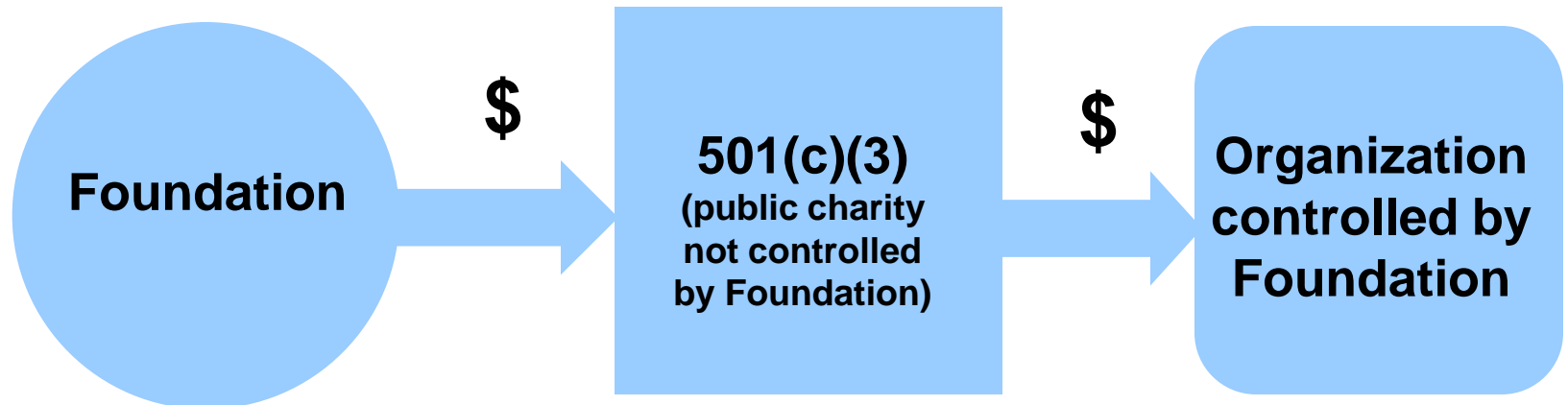
Internal Revenue Code section 4941 penalizes, as self-dealing, most direct and indirect transactions between a private foundation and a disqualified person.



- **Treasury Regulations (re payments to government officials):**

A grant by a private foundation is earmarked if such grant is made pursuant to an agreement, either oral or written, that the grant **will be used** by any named individual. Thus, a grant by a private foundation shall not constitute an indirect act of self-dealing even though such foundation had **reason to believe** that certain government officials would derive benefits from such grant so long as the **intermediary organization exercises control, in fact**, over the selection process and actually makes the selection **completely independently** of the private foundation.

## Managing 5% distribution requirement --avoiding grants to controlled organizations

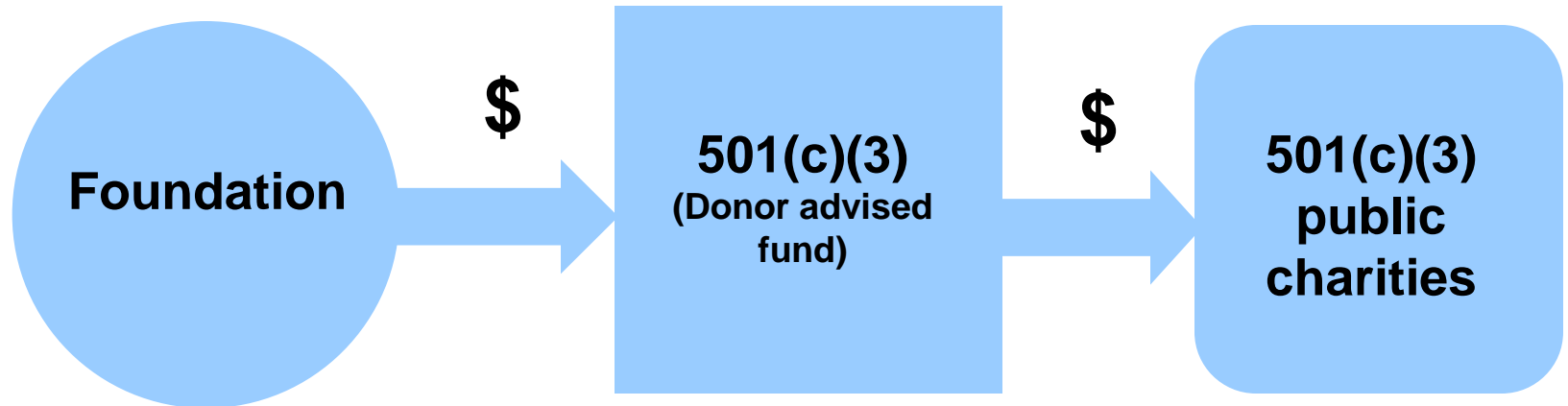


Internal Revenue Code section 4942(g)(1) requires that in order to be considered a distribution that counts against a foundation's 5% distribution requirement, a grant must *not* (except under certain limited circumstances) be to an organization controlled (directly or indirectly) by the foundation or one or more disqualified persons, or to another private foundation.

- **Treasury Regulations:**

A contribution by a private foundation to a donee organization which the donee uses to make payments to another organization (the secondary donee) shall not be regarded as a contribution by the private foundation to the secondary donee if the distributing foundation does not  **earmark** the use of the contribution for any named secondary donee and does not **retain power to cause the selection** of the secondary donee by the organization to which such foundation has made the contribution. For purposes of this subparagraph, a contribution described herein shall not be regarded as a contribution by the foundation to the secondary donee even though such foundation **has reason to believe that certain organizations would derive benefits** from such contribution so long as the original donee organization exercises **control, in fact,** over the selection process and actually makes the selection **completely independently** of such foundation.

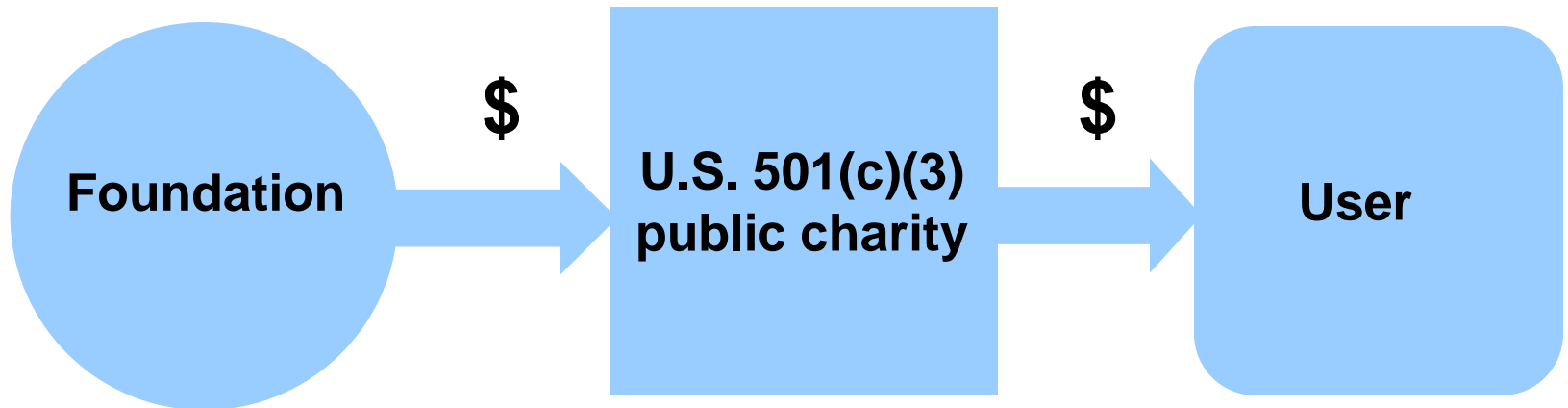
## Managing 5% distribution requirement --using donor advised funds



Internal Revenue Code section 4942(a) requires that qualifying distributions for Year 1 be made by the end of Year 2.

- “Parking” of funds in a donor advised fund to meet the 5% distribution requirement was criticized by some prior to the adoption of the Pension Protection Act of 2006, but was not identified as a problem or addressed in the Act. Nonetheless, it is a strategy that should be used sparingly.

## Reducing due diligence and monitoring responsibilities



- Expenditure responsibility grants require a pre-grant inquiry and periodic reporting
- Grants to foreign organizations generally require investigation to mitigate risk of funding terrorism
- As a fiduciary matter, all grants will require some due diligence where identity of “user” is known

## ***Reducing—not eliminating—* due diligence and monitoring responsibilities**

- Foundation must use reasonable care in all grant decisions
- When there is an expectation that grant funds will be distributed to a particular user or for a particular use, due diligence is advised

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# What are the risks?



- **Tension**
  - Objective of using an intermediary: get the benefits of funding an organization without some of the administrative burden or risk that goes along with making a grant to that organization
  - Having the best of both worlds presents some of the risks of each world

Risk #1:

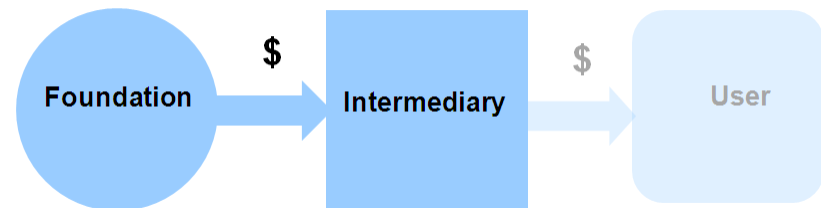
**Foundation does not control the ultimate distribution of the grant**

- Grantee may choose to keep the funds or distribute some or all to a different user

## Risk #2:

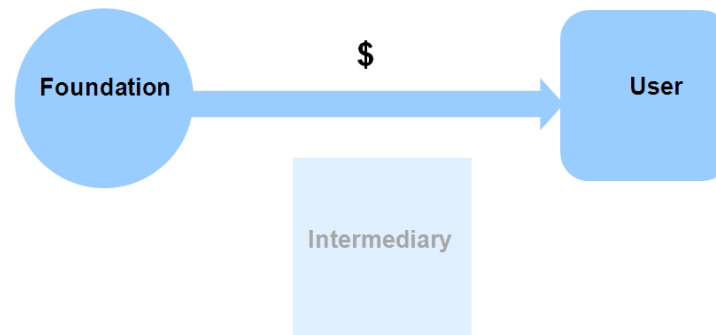
### **Foundation has no direct legal relationship with the user**

- Foundation has no recourse against user that fails to carry out the funded program, diverts funds, or otherwise fails to live up to the terms of the project or grant agreement



### Risk #3:

## User's actions may still impact Foundation

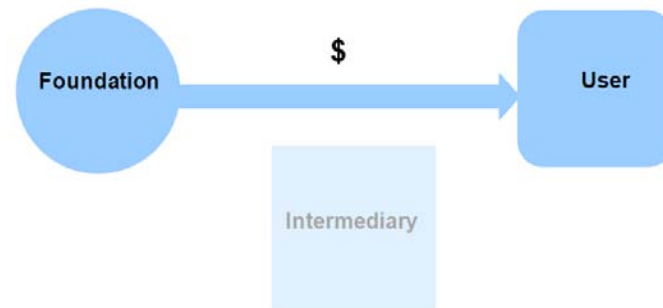


### Risk #3, cont'd:

- Use of Foundation funds for inappropriate or illegal purposes may be attributed to Foundation under some circumstances, particularly if Foundation failed to do adequate due diligence or build in protections
  - Funding of terrorism
  - Bribery (U.S. Foreign Corrupt Practices Act)
  - Violation of U.S. export sanctions (activities in N. Korea, Sudan, Syria, Iran, Cuba)
  - Political activities
  - Private benefit to Foundation-related parties

## Risk #4:

**Intermediary may be ignored, defeating the purpose of using the intermediary**



## Risk #4, cont'd:

- This risk is greatest where behavior of the parties is inconsistent with anti-earmarking documentation
  - Wink-and-a-nod
  - Conflicting documentation
  - Direct communication, reporting between Foundation and user
  - Inconsistent tax reporting, accounting
  - User publicly recognizing Foundation, rather than intermediary, as its donor

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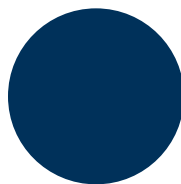
# Wrap-Up



- **When can using an intermediary help?**
  - Grants that support
    - Non-501(c)(3) foreign NGOs
    - Start-up organizations
    - Grants to individuals for study, travel, etc.
    - Potential self-dealing situations
  - Managing 5% distribution requirement
    - Controlled organizations
    - Timing
  - Reducing due diligence

- **How can an intermediary help?**
  - Intermediary is treated as the Foundation's grantee
  - Grantee must not be earmarked for another user
  - Documents and parties' actions must be consistent

- **What are the risks?**
  - Foundation does not control ultimate use of its grant
  - Foundation has no direct relationship with user
  - Activities of user may be attributed to Foundation
  - Intermediary might be ignored



# Questions?

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