advance by the Commissioner will be deemed satisfied if the grantor utilizes any procedure in good faith in awarding a grant to an individual which, in fact, is reasonably calculated to provide objectivity and nondiscrimination in the awarding of such grant and to result in a grant which complies with the conditions of section 4945(g) (1), (2), or (3).

§ 53.4945–5 Grants to organizations.

(a) Grants to nonpublic organizations—

(1) In general. Under section 4945(d)(4) the term “taxable expenditure” includes any amount paid or incurred by a private foundation as a grant to an organization (other than an organization described in section 509(a) (1), (2) or (3)), unless the private foundation exercises expenditure responsibility with respect to such grant in accordance with section 4945(h). However, the granting foundation does not have to exercise expenditure responsibility with respect to amounts granted to organizations described in section 4945(f).

(2) “Grants” described. For a description of the term “grants”, see §53.4945–4(a)(2).

(3) Section 509(a) (1), (2), and (3) organizations. See section 508(b) and the regulations thereunder for rules relating to when a grantor may rely on a potential grantee’s characterization of its status as set forth in the notice described in section 508(b).

(4) Certain “public” organizations. For purposes of this section, an organization will be treated as a section 509(a)(1) organization if:

(i) It qualifies as such under paragraph (a) of §1.509(a)–2 of this chapter;

(ii) It is an organization described in section 170(c)(1) or 511(a)(2)(B), even if it is not described in section 501(c)(3); or

(iii) It is a foreign government, or an agency or instrumentality thereof, or an international organization designated as such by Executive order under 22 U.S.C. 288, even if it is not described in section 501(c)(3).

However, any grant to an organization referred to in this subparagraph must be made exclusively for charitable purposes as described in section 170(c)(2)(B).

(5) Certain foreign organizations. If a private foundation makes a grant to a foreign organization which does not have a ruling or determination letter that it is an organization described in section 509(a)(1), (2), or (3), such grant will not be treated as a grant made to an organization other than an organization described in section 509(a)(1), (2), or (3) if the grantor private foundation has made a good faith determination that the grantee organization is an organization described in section 509(a)(1), (2), or (3). Such a “good faith determination” ordinarily will be considered as made where the determination is based on an affidavit of the grantee organization or an opinion of counsel (of the grantor or the grantee) that the grantee is an organization described in section 509(a)(1), (2), or (3). Such an affidavit or opinion must set forth sufficient facts concerning the operations and support of the grantee for the Internal Revenue Service to determine that the grantee would be likely to qualify as an organization described in section 509(a)(1), (2), or (3). See paragraphs (b)(5) and (b)(6) of this section for other special rules relating to foreign organizations.

(6) Certain earmarked grants—(i) In general. A grant by a private foundation to a grantee organization which the grantee organization uses to make payments to another organization (the secondary grantee) shall not be regarded as a grant by the 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. For purposes of this subdivision, a grant described herein shall not be regarded as a grant by the private foundation to the secondary grantee even though such grantor foundation may exercise control, in fact, over the selection process and actually makes the selection completely independently of the private foundation.
(i) To governmental agencies. If a private foundation makes a grant to an organization described in section 170(c)(1) and such grant is earmarked for use by another organization, the granting foundation need not exercise expenditure responsibility with respect to such grant if the section 170(c)(1) organization satisfies the Commissioner in advance that:

(a) Its grant-making program is in furtherance of a purpose described in section 170(c)(2)(B), and

(b) The section 170(c)(1) organization exercises “expenditure responsibility” in a manner that would satisfy this section if it applied to such section 170(c)(1) organization.

However, with respect to such grant, the granting foundation must make the reports required by section 4945(h)(3) and paragraph (d) of this section, unless such grant is earmarked for use by an organization described in section 509(a) (1), (2), or (3).

(b) Expenditure responsibility—(1) In general. A private foundation is not an insurer of the activity of the organization to which it makes a grant. Thus, satisfaction of the requirements of sections 4945(d)(4) and (h) and of subparagraph (3) or (4) of this paragraph, will ordinarily mean that the grantor foundation will not have violated section 4945(d) (1) or (2). A private foundation will be considered to be exercising “expenditure responsibility” under section 4945(h) as long as it exerts all reasonable efforts and establishes adequate procedures:

(i) To see that the grant is spent solely for the purpose for which made,

(ii) To obtain full and complete reports from the grantee on how the funds are spent, and

(iii) To make full and detailed reports with respect to such expenditures to the Commissioner.

In cases in which pursuant to paragraph (a)(6) of this section a grant is considered made to a secondary grantee rather than the primary grantee, the grantor foundation’s obligation to obtain reports from the grantee pursuant to section 4945(h)(2) and this section will be satisfied if appropriate reports are obtained from the secondary grantee. For rules relating to expenditure responsibility with respect to transfers of assets described in section 507(b)(2), see section 507(b)(2) and the regulations thereunder.

(2) Pre-grant inquiry—(i) Before making a grant to an organization with respect to which expenditure responsibility must be exercised under this section, a private foundation should conduct a limited inquiry concerning the potential grantee. Such inquiry should be complete enough to give a reasonable man assurance that the grantee will use the grant for the proper purposes. The inquiry should concern itself with matters such as: (a) The identity, prior history and experience (if any) of the grantee organization and its managers; and (b) any knowledge which the private foundation has (based on prior experience or otherwise) of, or other information which is readily available concerning, the management, activities, and practices of the grantee organization. The scope of the inquiry might be expected to vary from case to case depending upon the size and purpose of the grant, the period over which it is to be paid, and the prior experience which the grantor has had with respect to the capacity of the grantee to use the grant for the proper purposes. For example, if the grantee has made proper use of all prior grants to it by the grantor and filed the required reports substantiating such use, no further pregrant inquiry will ordinarily be necessary. Similarly, in the case of an organization, such as a trust described in section 4947(a)(2), which is required by the terms of its governing instrument to make payments to a specified organization exempt from taxation under section 501(a), a less extensive pregrant inquiry is required than in the case of a private foundation possessing discretion with respect to the distribution of funds.

(ii) The provisions of this subparagraph may be illustrated by the following examples:

Example 1. Officials of M, a newly established organization which is described in section 501(c)(4), request a grant from X foundation to be used for a proposed program to combat drug abuse by establishing neighborhood clinics in certain ghetto areas of a city. Before making a grant to M, X makes an inquiry concerning the identity, prior history and experience of the officials of M. X obtains information pertaining to the officials...
of M from references supplied by these officials. Since one of the references indicated that A, an official of M, has an arrest record, police records are also checked and A’s probation officer is interviewed.

The inquiry also shows M has no previous history of administering grants and that the officials of M have had no experience in administering programs of this nature. However, in the opinion of X’s managers, M’s officials (including A who appears to be fully rehabilitated after having been convicted of a narcotics violation several years ago) are well qualified to conduct this program since they are members of the communities in which the clinics are to be established and are more likely to be trusted by drug users in these communities than are outsiders. Under these circumstances X has complied with the requirements of this subparagraph and a grant to M for its proposed program will not be treated as a taxable expenditure solely because of the operation of this subparagraph.

Example 1. S foundation requests a grant from Z foundation for use in S’s program of providing medical research fellowships. S has been engaged in this program for several years and has received large numbers of grants from other foundations. Z’s managers know that the reputations of S and of S’s officials are good. Z’s managers also have been advised by managers of W foundation that W had recently made a grant to S and that W’s managers were satisfied that such grant has been used for the purposes for which it was made. Under these circumstances Z has enough information to have such assurance as a reasonable man would require that the grant to S will be used for proper purposes. Consequently, Z is under no obligation to make any further pregrant inquiry pursuant to this subparagraph.

Example 2. Foundation Y wishes to make a grant to foundation R for use in R’s scholarship program. Y has made similar grants to R annually for the last several years and knows that R’s managers have observed the terms of the previous grants and have made all requested reports with respect to such grants. No changes in R’s management have occurred during the past several years. Under these circumstances, Y has enough information to have such assurance as a reasonable man would require that the grant to R will be used for proper purposes. Consequently, Y is under no obligation to make any further pregrant inquiry pursuant to this subparagraph.

Example 3. Foundation M wishes to make a grant to foundation R for its proposed program of rehabilitating narcotics violators. The inquiry also shows M has no previous history of administering grants and that the officials of M have had no experience in administering programs of this nature. However, in the opinion of Y’s managers, M’s officials (including A who appears to be rehabilitated after having been convicted of a narcotics violation several years ago) are well qualified to conduct this program since they are members of the communities in which the clinics are to be established and are more likely to be trusted by drug users in these communities than are outsiders. Under these circumstances Y has complied with the requirements of this subparagraph and a grant to M for its proposed program will not be treated as a taxable expenditure solely because of the operation of this subparagraph.

§ 53.4945–5

(3) Terms of grants. Except as provided in subparagraph (4) of this paragraph, in order to meet the expenditure responsibility requirements of section 4945(h), a private foundation must require that each grant to an organization, with respect to which expenditure responsibility must be exercised under this section, be made subject to a written commitment signed by an appropriate officer, director, or trustee of the grantee organization. Such commitment must include an agreement by the grantee:

(i) To repay any portion of the amount granted which is not used for the purposes of the grant,

(ii) To submit full and complete annual reports on the manner in which the funds are spent and the progress made in accomplishing the purposes of the grant, except as provided in paragraph (c)(2) of this section,

(iii) To maintain records of receipts and expenditures and to make its books and records available to the grantor at reasonable times, and

(iv) Not to use any of the funds:

(a) To carry on propaganda, or otherwise to attempt, to influence legislation (within the meaning of section 4945(d)(1)),

(b) To influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive (within the meaning of section 4945(d)(2)),

(c) To make any grant which does not comply with the requirements of section 4945(d) (3) or (4), or

(d) To undertake any activity for any purpose other than one specified in section 170(c)(2)(B).

The agreement must also clearly specify the purposes of the grant. Such purposes may include contributing for capital endowment, for the purchase of capital equipment, or for general support provided that neither the grants nor the income therefrom may be used for purposes other than those described in section 170(c)(2)(B).

(4) Terms of program-related investments. In order to meet the expenditure responsibility requirements of section 4945(h), with regard to the making of a program-related investment (as defined in section 4944 and the regulations thereunder), a private foundation must require that each such investment with respect to which expenditure responsibility must be exercised under section 4945(d)(4) and (h) and this section be made subject to a written commitment.
signed by an appropriate officer, director, or trustee of the recipient organization. Such commitment must specify the purpose of the investment and must include an agreement by the organization:

1. To use all the funds received from the private foundation (as determined under paragraph (c)(3) of this section) only for the purposes of the investment and to repay any portion not used for such purposes, provided that, with respect to equity investments, such repayment shall be made only to the extent permitted by applicable law concerning distributions to holders of equity interests,

2. At least once a year during the existence of the program-related investment, to submit full and complete financial reports of the type ordinarily required by commercial investors under similar circumstances and a statement that it has complied with the terms of the investment,

3. To maintain books and records adequate to provide information ordinarily required by commercial investors under similar circumstances and to make such books and records available to the private foundation at reasonable times, and

4. Not to use any of the funds:
   (a) To carry on propaganda, or otherwise to attempt, to influence legislation (within the meaning of section 4945(d)(1)),
   (b) To influence the outcome of any specific public election, or to carry on directly or indirectly, and voter registration drive (within the meaning of section 4945(d)(2)), or
   (c) With respect to any recipient which is a private foundation (as defined in section 509(a)), to make any grant which does not comply with the requirements of section 4945 (d) (3) or (4).

5. Certain grants to foreign organizations. With respect to a grant to a foreign organization (other than an organization described in section 509(a) (1), (2), or (3) or treated as so described pursuant to paragraph (a)(4) or (a)(5) of this section), subparagraph (3)(iv) or (4)(iv) of this paragraph shall be deemed satisfied if the agreement referred to in subparagraph (3) or (4) of this paragraph imposes restrictions on the use of the grant substantially equivalent to the limitations imposed on a domestic private foundation under section 4945(d). Such restrictions may be phrased in appropriate terms under foreign law or custom and ordinarily will be considered sufficient if an affidavit or opinion of counsel (of the grantor or grantee) is obtained stating that, under foreign law or custom, the agreement imposes restrictions on the use of the grant substantially equivalent to the restrictions imposed on a domestic private foundation under subparagraph (3) or (4) of this paragraph.

6. Special rules for grants by foreign private foundations. With respect to activities in jurisdictions other than those described in section 170(c)(2)(A), the failure of a foreign private foundation which is described in section 4948(b) to comply with subparagraph (3) or (4) of this paragraph with respect to a grant to an organization shall not constitute an act or failure to act which is a prohibited transaction (within the meaning of section 4948(c)(2)).

7. Expenditure responsibility with respect to certain transfers of assets described in section 507—(1) Transfers of assets described in section 507(b)(2). For rules relating to the extent to which the expenditure responsibility rules contained in section 4945 (d)(4) and (h) and this section apply to transfers of assets described in section 507(b)(2), see §§1.507-3(a)(7), 1.507-3 (a)(8)(iii)(f), and 1.507-3(a)(9) of this chapter.

(2) Certain other transfers of assets. For rules relating to the extent to which the expenditure responsibility rules contained in section 4945 (d)(4) and (h) and this section apply to certain other transfers of assets described in §1.507–3(b) of this chapter, see §1.507–3(b) of this chapter.

8. Restrictions on grants (other than program-related investments) to organizations not described in section 501(c)(3). For other restrictions on certain grants (other than program-related investments) to organizations which are not described in section 501(c)(3), see §53.4945–6(c).

(c) Reports from grantees—(1) In general. In the case of grants described in section 4945(d)(4), except as provided in subparagraph (2) of this paragraph, the
granting private foundation shall require reports on the use of the funds, compliance with the terms of the grant, and the progress made by the grantee toward achieving the purposes for which the grant was made. The grantee shall make such reports as of the end of its annual accounting period within which the grant or any portion thereof is received and all such subsequent periods until the grant funds are expended in full or the period of the grantee for which such reports shall be furnished to the grantor within a reasonable period of time after the close of the annual accounting period of the grantee for which such reports are made. Within a reasonable period of time after the close of its annual accounting period during which the use of the grant funds is completed, the grantee must make a final report with respect to all expenditures made from such funds (including salaries, travel, and supplies), and indicating the progress made toward the goals of the grant. The grantor need not conduct any independent verification of such reports unless it has reason to doubt their accuracy or reliability.

(2) Capital endowment grants to exempt private foundations. If a private foundation makes a grant described in section 4945(d)(4) to a private foundation which is exempt from taxation under section 501(a) for endowment, for the purchase of capital equipment, or for other capital purposes, the grantor foundation shall require reports from the grantee on the use of the principal and the income (if any) from the grant funds. The grantee shall make such reports annually for its taxable year in which the grant was made and the immediately succeeding 2 taxable years. Only if it is reasonably apparent to the grantor that, before the end of such second succeeding taxable year, neither the principal, the income from the grant funds, nor the equipment purchased with the grant funds has been used for any purpose which would result in liability for tax under section 4945(d), the grantor may then allow such reports to be discontinued.

(3) Grantees' accounting and recordkeeping procedures. (i) A private foundation grantee exempt from taxation under section 501(a) (or the recipient of a program-related investment) need not segregate grant funds physically nor separately account for such funds on its books unless the grantor requires such treatment of the grant funds. If such a grantee neither physically segregates grant funds nor establishes separate accounts on its books, grants received within a given taxable year beginning after December 31, 1969, shall be deemed, for purposes of section 4945, to be expended before grants received in a succeeding taxable year. In such case expenditures of grants received within any such taxable year shall be prorated among all such grants.

In accounting for grant expenditures, private foundations may make the necessary computations on a cumulative annual basis (or, where appropriate, as of the date for which the computations are made). The rules set forth in the preceding three sentences shall apply to the extent they are consistent with the available records of the grantee and with the grantee's treatment of qualifying distributions under section 4942(h) and the regulations thereunder. The records of expenditures, as well as copies of the reports submitted to the grantor, must be kept for at least 4 years after completion of the use of the grant funds.

(ii) For rules relating to accounting and recordkeeping requirements for grantees other than those described in subdivision (i) of this subparagraph, see §§ 53.4945–5(b)(8) and 53.4945–6(c).

(4) Reliance on information supplied by grantee. A private foundation exercising expenditure responsibility with respect to its grants may rely on adequate records or other sufficient evidence supplied by the grantee organization (such as a statement by an appropriate officer, director or trustee of such grantee organization) showing, to the extent applicable, the information which the grantor must report to the Internal Revenue Service in accordance with paragraph (d)(2) of this section.

(d) Reporting to Internal Revenue Service by grantor—(1) In general. To satisfy the reportmaking requirements of section 4945(h)(3), a granting foundation must provide the required information
on its annual information return, required to be filed by section 6033, for each taxable year with respect to each grant made during the taxable year which is subject to the expenditure responsibility requirements of section 4945(h). Such information must also be provided on such return with respect to each grant subject to such requirements upon which any amount or any report is outstanding at any time during the taxable year. However, with respect to any grant made for endowment or other capital purposes, the grantor must provide the required information only for any taxable year for which the grantor must require a report from the grantee under paragraph (c)(2) of this section. The requirements of this subparagraph with respect to any grant may be satisfied by submission with the foundation’s information return of a report received from the grantee, if the information required by subparagraph (2) of this paragraph is contained in such report.

(2) Contents of report. The report required by this paragraph shall include the following information:

(i) The name and address of the grantee.

(ii) The date and amount of the grant.

(iii) The purpose of the grant.

(iv) The amounts expended by the grantee (based upon the most recent report received from the grantee).

(v) Whether the grantee has diverted any portion of the funds (or the income therefrom in the case of an endowment grant) from the purpose of the grant (to the knowledge of the grantor).

(vi) The dates of any reports received from the grantee.

(vii) The date and results of any verification of the grantee’s reports undertaken pursuant to and to the extent required under paragraph (c)(1) of this section by the grantor or by others at the direction of the grantor.

(3) Recordkeeping requirements. In addition to the information included on the information return, a granting foundation shall make available to the Internal Revenue Service at the foundation’s principal office each of the following items:

(i) A copy of the agreement covering each “expenditure responsibility” grant made during the taxable year.

(ii) A copy of each report received during the taxable year from each grantee on any “expenditure responsibility” grant, and

(iii) A copy of each report made by the grantor’s personnel or independent auditors of any audits or other investigations made during the taxable year with respect to any “expenditure responsibility” grant.

(4) Reports received after the close of grantor’s accounting year. Data contained in reports required by this paragraph, which reports are received by a private foundation after the close of its accounting year but before the due date of its information return for that year, need not be reported on such return, but may be reported on the grantor’s information return for the year in which such reports are received from the grantee.

(e) Violations of expenditure responsibility requirements—(1) Diversions by grantee. (i) Any diversion of grant funds (including the income therefrom in the case of an endowment grant) by the grantee to any use not in furtherance of a purpose specified in the grant may result in the diverted portion of such grant being treated as a taxable expenditure of the grantor under section 4945(d)(4). However, for purposes of this section, the fact that a grantee does not use any portion of the grant funds as indicated in the original budget projection shall not be treated as a diversion if the use to which the funds are committed is consistent with the purpose of the grant as stated in the grant agreement and does not result in a violation of the terms of such agreement required to be included by paragraph (b)(3) or (b)(4) of this section.

(ii) In any event, a grantor will not be treated as having made a taxable expenditure under section 4945(d)(4) solely by reason of a diversion by the grantee, if the grantor has complied with subdivision (iii) (a) and (b) or (iv) (a) and (b) of this subparagraph, whichever is applicable.

(iii) In cases in which the grantor foundation determines that any part of
a grant has been used for improper purposes and the grantee has not previously diverted grant funds, the foundation will not be treated as having made a taxable expenditure solely by reason of the diversion so long as the foundation:

(a) Is taking all reasonable and appropriate steps either to recover the grant funds or to insure the restoration of the diverted funds and the dedication (consistent with the requirements of (b) (1) and (2) of this subdivision) of the other grant funds held by the grantee to the purposes being financed by the grant, except that if, in fact, some or all of the diverted funds are not so restored or recovered, then the foundation must take all reasonable and appropriate steps to recover all of the grant funds, and

(b) Withholds any further payments to the grantee after the grantor becomes aware that a diversion may have taken place (hereinafter referred to as “further payments”) until it has:

(1) Received the grantee’s assurances that future diversions will not occur, and

(2) Required the grantee to take extraordinary precautions to prevent future diversions from occurring.

If a foundation is treated as having made a taxable expenditure under this subparagraph in a case to which this subdivision applies, then unless the foundation meets the requirements of (a) of this subdivision, the amount of the taxable expenditure shall be the amount of the diversion plus the amount of any further payments to the same grantee.

(v) The phrase “all reasonable and appropriate steps” (as used in subdivisions (iii) and (iv) of this subparagraph) includes legal action where appropriate but need not include legal action if such action would in all probability not result in the satisfaction of execution on a judgment.

(2) Grantee’s failure to make reports. A failure by the grantee to make the reports required by paragraph (c) of this section (or the making of inadequate reports) shall result in the grant’s being treated as a taxable expenditure by the grantor unless the grantor:

(i) Has made the grant in accordance with paragraph (b) of this section,

(ii) Has complied with the reporting requirements contained in paragraph (d) of this section,
(iii) Makes a reasonable effort to obtain the required report, and
(iv) Withholds all future payments on this grant and on any other grant to the same grantee until such report is furnished.

(3) Violations by the grantor. In addition to the situations described in subparagraphs (1) and (2) of this paragraph, a grant which is subject to the expenditure responsibility requirements of section 4945(h) will be considered a taxable expenditure of the granting foundation if the grantor:

(i) Fails to make a pregrant inquiry as described in paragraph (b)(2) of this section,
(ii) Fails to make the grant in accordance with a procedure consistent with the requirements of paragraph (b)(3) or (4) of this section, or
(iii) Fails to report to the Internal Revenue Service as provided in paragraph (d) of this section.

(f) Effective dates—(1) In general. This section shall apply to all grants which are subject to the expenditure responsibility requirements of section 4945(d)(4) and (h) and which are made by private foundations more than 90 days after October 30, 1972.

(2) Transitional rules—(i) Certain grants awarded prior to May 27, 1969. Section 4945(d)(4) and (h) and this section shall not apply to a grant to a private foundation which is not controlled, directly or indirectly, by the grantor foundation or one or more disqualified persons (as defined in section 4946) with respect to the grantor foundation, provided that such grant:

(a) Is made pursuant to a written commitment which was binding on May 26, 1969, and at all times thereafter,
(b) Is made for one or more of the purposes described in section 170(c)(2)(B), and
(c) Is to be paid out to such grantee foundation on or before December 31, 1974.

(ii) Grants or expenditures committed prior to January 1, 1970. Except as provided in paragraph (e)(2)(i) of §53.4945–4, section 4945 shall not apply to a grant or an expenditure for section 170(c)(2)(B) purposes made on or after January 1, 1970, if the grant or expenditure was made pursuant to a commitment entered into prior to such date, but only if (in the case of a grant or an expenditure other than an unlimited general-purpose grant to an organization) such commitment is reasonable in amount in light of the purposes of the grant. For purposes of this subdivision, a commitment will be considered entered into prior to January 1, 1970, if prior to such date, the amount and nature of the payments to be made and the name of the payee were entered on the records of the payor, or were otherwise adequately evidenced, or the notice of the payment to be received was communicated to the payee in writing.

(iii) Grants awarded on or after January 1, 1970. Paragraphs (b), (c), and (d) of this section shall not apply to grants awarded on or after January 1, 1970, but prior to the expiration of 90 days after October 30, 1972, if the grantor has made reasonable efforts, and has established adequate procedures such as a prudent man would adopt in managing his own property, to see that the grant is spent solely for the purpose for which made, to obtain full and complete reports from the grantee on how the funds are spent, and to make full and detailed reports with respect to such grant to the Commissioner. With respect to any return filed with the Internal Revenue Service before the expiration of 90 days after October 30, 1972, the grantor may treat reports which satisfy the requirements of the statement to be attached to Form 4720 for the year 1970 under “Specific Instructions—Question B” (items (1) through (5)) as satisfying the grantor reporting requirements with respect to “expenditure responsibility” grants. In the case of a private foundation required to file an annual return for a taxable year ending after January 1, 1970, and before December 31, 1970, the reporting requirements imposed by section 4945(h)(3) for such period shall be regarded as satisfied if such reports are made on the annual return for its first taxable year beginning after December 31, 1969.