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GRANTMAKING IN MEXICO

by Vivian L. Cavalieri
Caplin & Drysdale, Chartered

U.S. private foundations are making more grants abroad. Foundations are becoming increasingly familiar with—and less intimidated by—the tax rules that must be followed when making grants to foreign organizations, and the IRS has approved streamlined procedures which facilitate making such grants. The U.S.-Mexico income tax treaty makes it especially easy to make grants to Mexican charities.

1. Foreign grantmaking in general

For many years, U.S. private foundations—particularly smaller ones—tended to shy away from foreign grantmaking. Foundations were often discouraged by the need to determine whether a particular foreign organization is the equivalent of a U.S. tax-exempt “public charity.” Without such a determination, the grantor foundation must exercise “expenditure responsibility” with respect to the grant, a process that many foundations prefer to avoid.¹

Several years ago, the IRS simplified the procedure for making the necessary determination. The rigors of expenditure responsibility can now be avoided where a grantor foundation determines—on the basis of information furnished by the prospective grantee in a “currently qualified affidavit”—that the prospective grantee is equivalent to a U.S. tax-exempt

¹ To avoid an excise tax, a grantor private foundation must exercise expenditure responsibility with respect to each grant it makes to an entity other than (1) a “public charity” described in section 509(a)(1), (a)(2) or (a)(3), or (2) an “exempt operating foundation” described in section 4940(d)(2). Details regarding the components of expenditure responsibility—a pregrant inquiry, a written agreement with required terms, and reporting by both the grantor and the grantee—appear in section 4945 and the accompanying Treasury Department regulations. (References to sections are to sections of the Internal Revenue Code of 1986, as amended. References to regulations are to the Treasury Department regulations in effect under it.)

Under the regulations, a grantor private foundation may treat a foreign organization as the equivalent of a U.S. tax-exempt public charity if a “foundation manager” (1) makes a “reasonable judgment” that the organization is described in section 501(c)(3), other than by virtue of section 509(a)(4), and (2) makes a “good faith determination” that the organization is described in section 509(a)(1), (a)(2), or (a)(3). Such a good faith determination is normally based upon an affidavit of the foreign organization or an opinion of counsel (of the grantor foundation or the foreign organization) that the foreign organization is described in one of those sections. Treas. Reg. §§ 53.4945-5(a)(5); 53.4945-6(c)(2).

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public charity.² The affidavit need not be completed for the prospective grantor; a foundation may rely upon information furnished to another prospective grantor, provided that the information is current.

2. The U.S.-Mexico tax treaty

Grantmaking to Mexican charities was further simplified with the adoption of the U.S.-Mexico income tax treaty and the accompanying protocol (together, the "Treaty"). The effect of the Treaty is to treat any organization classified as a public charity by the Mexican authorities under Mexican law as a public charity described in section 509(a)(1) or (a)(2) of the U.S. Internal Revenue Code.³ Mexico is the only foreign country to which the U.S. currently accords such deference.⁴

For these purposes, an organization classified as a public charity in Mexico is one that has been granted special authorization as an organization described in Article 70-B of the Mexican income tax law ("Article 70-B") by the Mexican Ministry of Finance and Public Credit (Secretaría de Hacienda y Crédito Público). It is not enough that an organization meet the criteria set forth in Article 70-B. What is needed is special authorization from the Ministry (which reflects the fact that the organization has met not only the criteria set forth in Article

² A "current qualified affidavit" is described, and a sample affidavit appears, in Rev. Proc. 92-94, 1992-2 C.B. 507. Such an affidavit enables the grantor foundation (1) to avoid exercising expenditure responsibility and (2) to treat the grant as a "qualifying distribution" in satisfaction of the grantor foundation's minimum distribution requirement under section 4942. The affidavit may not be used, however, if the grant is a transfer pursuant to a merger, liquidation, organization, or other reorganization.

³ Under the Treaty, which went into effect on December 28, 1993, Article 70-B of the Mexican income tax law and sections 509(a)(1) and (a)(2) are deemed to provide "essentially equivalent standards." See Article 22 of the Treaty; Point 17 of the related protocol. Note, however, that this does not apply with respect to churches or conventions or associations of churches.

⁴ While treaties between the U.S. and certain other countries (or related protocols and diplomatic notes) indicate that the contracting countries could agree to treat an organization that qualifies as a public charity in one country as automatically qualifying as a public charity in the other country, no such agreements have been entered into to date except with Mexico. Also, no other treaty expressly provides that a private foundation may treat an organization treated as a public charity by virtue of the treaty as equivalent to a U.S. public charity for purposes of the expenditure responsibility rules. The Treaty accords other significant benefits as well. In particular, the Treaty permits a resident of the U.S. to deduct against Mexican-source income contributions to organizations that have been classified as a public charity under Mexican law organizations, subject to the percentage limits that normally apply to contributions to U.S. public charities. Thus, cash contributions by an individual are deductible to the extent of 50% (and contributions of property to the extent of 30%) of the individual's Mexican-source income. Similarly, contributions by a corporation are deductible to the extent of 10% of the corporation's Mexican-source income.

70-B but some additional requirements as well). Thus, while 2,500 organizations currently enjoy Article 70-B status (by virtue of meeting the criteria set forth in Article 70-B), to date only about 70 of those have requested and received the requisite special authorization.

The Treaty has had less of an effect upon foundation grantmaking than was anticipated—at least at the outset. This was due both to limited awareness of the Treaty's existence among U.S. grantmaking foundations and to some delays in establishing administrative procedures under which Mexican organizations could qualify for Article 70-B special authorization.⁵

This has now changed. U.S. foundations are becoming increasingly aware of the provisions of the Treaty. More importantly, over 70 charities have now qualified for special authorization.

The requirements for special authorization and the names of those organizations which have obtained such authorization are published in the Official Gazette (Diario Oficial) at least once a year. Once authorized, an organization remains so unless its authorization is revoked.

A current list of the charities that have received such authorization may be obtained by reviewing the issue of the Official Gazette which most recently published such a list or by contacting Consuelo Castro at the Mexican Center for Philanthropy (Centro Mexicano Para la Filantropia). Her telephone number is 011-525-256-3739. The Center's address is Mazatlán No. 96, Col. Condesa, 06140, México, D.F., and its internet address is cemefi@laneta.apc.org.

3. Foundation options

A foundation considering making grants to Mexican charities thus has several viable options:

- a. The foundation should ask a prospective grantee whether it has been granted the special Article 70-B authorization. If so, the foundation should obtain proof of the granting of such status (a copy of the list of authorized Article 70-B organizations that appears in the Official Gazette should suffice). The foundation should also obtain a signed statement from a principal officer of the prospective grantee that such status has not been revoked and that no such revocation is currently threatened.

If Article 70-B special authorization has been granted, the foundation may treat the prospective grantee as equivalent to a U.S. tax-exempt public charity—it

⁵ See M. Cerny, "Cross-Border Grant Making and the U.S.-Mexico Tax Treaty," vol. 10, no. 4 The Exempt Organization Tax Review, at 875 (October 1994).