MILW. BREWERS BASEBALL (Achievers Program)

501(c)(3) = Milwaukee Brewers Student Achievers Account

GIBBS, ROPER, LOOTS & WILLIAMS

ATTORNEYS AT LAW

735 NORTH WATER STREET

MILWAUKEE, WISCONSIN 53202

414 273-7010

February 12, 1987

Mr. Hillel Fradkin
The Lynde and Harry Bradley Foundation
777 East Wisconsin Avenue
Milwaukee, Wisconsin 53202

Dear Hillel:

You have requested our opinion regarding the legality of making a grant to the Milwaukee Brewers Baseball Club for purposes of recognizing academic achievement by giving Brewers tickets to students in the metropolitan Milwaukee area who meet certain achievement standards. We understand that the grant would be administered by the Brewers because of the impossibility of making individual grants to the several school districts involved. A portion of the grant--apparently $5,000 according to the letter of November 18, 1986 from Dick Hackett--would be used to pay a person to administer the program.

We are of the opinion that with the appropriate expenditure responsibility on the part of the Foundation such a grant would not jeopardize the status of the Foundation and would not be an improper use of Foundation funds.

Section 4945 of the Internal Revenue Code deals with taxable expenditures by private foundations. A copy of that code section accompanies this letter. The most relevant portions of the section have been highlighted for your review. Specifically, Section 4945 requires that, if a private foundation makes a grant to an organization that is not tax-exempt under Section 509(a) or is not an operating foundation, then the granting foundation must exercise "expenditure responsibility" to make certain that the grant is used only for permissible purposes. Expenditure responsibility is defined in Section 4945(h) to require that the granting foundation "exert all reasonable efforts and to establish adequate procedures" (a) to make certain that the grant is spent "solely for the purpose for which made;" (b) to obtain "full and complete reports" from the grantee organization about how the grant is spent; and (c) to make "full and detailed reports" to the IRS about such expenditures.

If you have any questions regarding this matter, please do not hesitate to call.

Very truly yours,

GIBBS, ROPER, LOOTS & WILLIAMS

Brent

Brent E. Gregory

BEG:dk

Enclosures

Internal Revenue Regulation § 53.4945-5 expands somewhat on the Code provisions and is also attached for your information. The regulation specifically states that the granting foundation "is not an insurer of the activity of the organization to which it makes a grant" (emphasis supplied). Nevertheless, rather rigorous standards are imposed. First of all, the granting foundation must make a "pre-grant inquiry." The regulation states, "Such inquiry should be complete enough to give a reasonable man assurance that the grantee will use the grant for the proper purposes."

Next the granting foundation must obtain a written commitment from the grantee signed by an officer or equivalent person. The terms of the commitment are specified in Reg. § 53.4945-5-(b)(3). The written commitment must include the grantee's agreement to repay any portion of the grant not used for the specified purpose, to submit annual reports on the way the funds are spent, to maintain records of receipts and expenditures, and not to use the funds for any impermissible purpose. This agreement must also "clearly specify the purposes of the grant."

Regulation § 53.4945-6(c) expands on the requirements for grants to "noncharitable" organizations. Again, a copy is enclosed for your review. Specifically, the grantee organization must agree to maintain the grant funds in a separate fund which is dedicated exclusively to one or more purposes described in Code § 170(C)(2)(B), those being religious, charitable, scientific, literary or educational purposes. The purpose of the proposed grant is obviously to encourage and recognize educational achievement, which is a permissible purpose. Still, the Brewers would certainly have to maintain a separate bank account for the grant moneys.

Given the cooperative attitude the Brewers personnel have shown thus far, we do not anticipate difficulties in getting the requisite agreement to allow the Foundation to exercise expenditure responsibility. Nevertheless, the requirements are specific and must be met.

Finally, as noted above, the Foundation must notify the IRS of its expenditure responsibility grants. This reporting is done as part of the Foundation's annual return. IRS Publication 578, "Tax Information for Private Foundations and Foundation Managers," indicates that the Foundation would have to make available to the IRS the following: (a) a copy of the grantee's signed agreement, (b) a copy of the report received from the grantee, and (c) a copy of each audit or investigation made during the year regarding the grant.

P-H EXPLANATION

means (1) actual knowledge of facts that are sufficient to make the expenditure taxable, (2) awareness that the expenditure may be taxable, and (3) negligent failure to make reasonable attempts to ascertain its taxable nature, or actual awareness that the expenditure is taxable. "Having reason to know" of a fact isn't "knowing," although it may be relevant to proof of actual knowledge of the fact. Reg. §53.4945-1(a)(2)(iii), ¶34,951.10.

The initial tax on the foundation is 10% of the expenditure; an additional tax of 100% is imposed if the foundation does not recover, or otherwise correct, the expenditure within the limits of the "taxable period." ¶34,952.5.

The initial tax on the foundation manager is 2½% (maximum $5,000) of the expenditure and the additional tax is 50% (maximum $10,000). ¶34,952.5.

LAW [¶34,951] CODE SEC. 4945. TAXES ON TAXABLE EXPENDITURES.

(a) **Initial Taxes.—**

(1) **On the foundation.—**There is hereby imposed on each taxable expenditure (as defined in subsection (d)) a tax equal to 10 percent of the amount thereof. The tax imposed by this paragraph shall be paid by the private foundation.

(2) **On the management.—**There is hereby imposed on the agreement of any foundation manager to the making of an expenditure, knowing that it is a taxable expenditure, a tax equal to 2½ percent of the amount thereof, unless such agreement is not willful and is due to reasonable cause. The tax imposed by this paragraph shall be paid by any foundation manager who agreed to the making of the expenditure.

(b) **Additional Taxes.—**

(1) **On the foundation.—**In any case in which an initial tax is imposed by subsection (a)(1) on a taxable expenditure and such expenditure is not corrected within the taxable period, there is hereby imposed a tax equal to 100 percent of the amount of the expenditure. The tax imposed by this paragraph shall be paid by the private foundation.

(2) **On the management.—**In any case in which an additional tax is imposed by paragraph (1), if a foundation manager refused to agree to part or all of the correction, there is hereby imposed a tax equal to 50 percent of the amount of the taxable expenditure. The tax imposed by this paragraph shall be paid by any foundation manager who refused to agree to part or all of the correction.

(c) **Special Rules.—**For purposes of subsections (a) and (b)—

(1) **Joint and several liability.—**If more than one person is liable under subsection (a)(2) or (b)(2) with respect to the making of a taxable expenditure, all such persons shall be jointly and severally liable under such paragraph with respect to such expenditure.

(2) **Limit for management.—**With respect to any one taxable expenditure, the maximum amount of the tax imposed by subsection (a)(2) shall not exceed $5,000, and the maximum amount of the tax imposed by subsection (b)(2) shall not exceed $10,000.

(d) **Taxable Expenditure.—**For purposes of this section, the term 'taxable expenditure' means any amount paid or incurred by a private foundation—

(1) to carry on propaganda, or otherwise to attempt, to influence legislation, within the meaning of subsection (e),

(2) except as provided in subsection (f), to influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive,

(3) as a grant to an individual for travel, study, or other similar purposes by such individual, unless such grant satisfies the requirements of subsection (g),

[1]*(4) as a grant to an organization unless—*

[Footnote ¶34,951] Matter in *italics* in Sec. 4945(d)(4) added by section 302(b), '84 TRA, which struck out:

L
A
W

(A) such organization is described in paragraph (1), (2), or (3) of section 509(a) or is an exempt operating foundation (as defined in section 4940(d)(2)), or

(B) the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h), or,

(5) for any purpose other than one specified in section 170(c)(2)(B).

(e) Activities Within Subsection (d)(1).—For purposes of subsection (d)(1), the term 'taxable expenditure' means any amount paid or incurred by a private foundation for—

(1) any attempt to influence any legislation through an attempt to affect the opinion of the general public or any segment thereof, and

(2) any attempt to influence legislation through communication with any member or employee of a legislative body, or with any other government official or employee who may participate in the formulation of the legislation (except technical advice or assistance provided to a governmental body or to a committee or other subdivision thereof in response to a written request by such body or subdivision, as the case may be),

other than through making available the results of nonpartisan analysis, study, or research. Paragraph (2) of this subsection shall not apply to any amount paid or incurred in connection with an appearance before, or communication to, any legislative body with respect to a possible decision of such body which might affect the existence of the private foundation, its powers and duties, its tax-exempt status, or the deduction of contributions to such foundation.

(f) Nonpartisan Activities Carried on by Certain Organizations.—Subsection (d)(2) shall not apply to any amount paid or incurred by any organization—

(1) which is described in section 501(c)(3) and exempt from taxation under section 501(a),

(2) the activities of which are nonpartisan, are not confined to one specific election period, and are carried on in 5 or more States,

(3) substantially all of the income of which is expended directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated,

(4) substantially all of the support (other than gross investment income as defined in section 509(e)) of which is received from exempt organizations, the general public, governmental units described in section 170(c)(1), or any combination of the foregoing; not more than 25 percent of such support is received from any one exempt organization (for this purpose treating private foundations which are described in section 4946(a)(1)(H) with respect to each other as one exempt organization); and not more than half of the support of which is received from gross investment income, and

(5) contributions to which for voter registration drives are not subject to conditions that they may be used only in specified States, possessions of the United States, or political subdivisions or other areas of any of the foregoing, or the District of Columbia, or that they may be used in only one specific election period.

In determining whether the organization meets the requirements of paragraph (4) for any taxable year of such organization, there shall be taken into account the support received by such organization during such taxable year and during the immediately preceding 4 taxable years of such organization (excluding therefrom any preceding taxable year which begins before January 1, 1970). Subsection (d)(4) shall not apply to any grant to an organization which meets the requirements of this subsection.

(g) Individual Grants.—Subsection (d)(3) shall not apply to an individual grant awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the Secretary, if it is demonstrated to the satisfaction of the Secretary that—

(1) the grant constitutes a scholarship or fellowship grant which is subject to the provisions of section 117(a) and is to be used for study at an educational organization described in section 170(b)(1)(A)(ii),

[Footnote ¶34,951 continued]

(1) "(4) as a grant to an organization (other than an organization described in paragraph (1), (2), or (3) of section 509(a)), unless the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h), or "

Effective date (Sec. 302(c), '84 TRA).—Applies to grants made after 12-31-84, in taxable years ending after such date.

L A W

(2) the grant constitutes a prize or award which is subject to the provisions of section 74(b), if the recipient of such prize or award is selected from the general public, or

(3) the purpose of the grant is to achieve a specific objective, produce a report or other similar product, or improve or enhance a literary, artistic, musical, scientific, teaching, or other similar capacity, skill, or talent of the grantee.

(h) Expenditure Responsibility.—The expenditure responsibility referred to in subsection (d)(4) means that the private foundation is responsible to exert all reasonable efforts and to establish adequate procedures—

(1) to see that the grant is spent solely for the purpose for which made,

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

(3) to make full and detailed reports with respect to such expenditures to the Secretary.

(i) Other Definitions.—For purposes of this section—

(1) Correction.—The terms "correction" and "correct" mean, with respect to any taxable expenditure, (A) recovering part or all of the expenditure to the extent recovery is possible, and where full recovery is not possible such additional corrective action as is prescribed by the Secretary by regulations, or (B) in the case of a failure to comply with subsection (h)(2) or (h)(3), obtaining or making the report in question.

(2) Taxable period.—The term "taxable period" means, with respect to any taxable expenditure, the period beginning with the date on which the taxable expenditure occurs and ending on the earlier of—

(A) the date of mailing of a notice of deficiency with respect to the tax imposed by subsection (a)(1) under section 6212,

(B) the date on which the tax imposed by subsection (a)(1) is assessed.

REGULATIONS

[¶34,951.10] The Regulation below doesn't reflect the changes made by the '84 Tax Reform Act (P.L 98-369, 7-18-84) in Sec. 4945.

Reg. §53.4945-1 Taxes on taxable expenditures. (TD 7215, filed 10-30-72; amended by TD 7299, filed 12-26-73; TD 7527, filed 12-23-77; TD 8084, filed 5-1-86.)

(a) Imposition of initial taxes—(1) Tax on private foundation. Section 4945(a)(1) of the Code imposes an excise tax on each taxable expenditure (as defined in section 4945(d)) of a private foundation. This tax is to be paid by the private foundation and is at the rate of 10 percent of the amount of each taxable expenditure.

(2) Tax on foundation manager—(i) In general. Section 4945(a)(2) of the Code imposes, under certain circumstances, an excise tax on the agreement of any foundation manager to the making of a taxable expenditure by a private foundation. This tax is imposed only in cases in which the following circumstances are present:

(a) A tax is imposed by section 4945(a)(1),

(b) Such foundation manager knows that the expenditure to which he agrees is a taxable expenditure, and

(c) Such agreement is willful and is not due to reasonable cause.

However, the tax with respect to any particular expenditure applies only to the agreement of those foundation managers who are authorized to approve, or to exercise discretion in recommending approval of, the making of the expenditure by the foundation and to those foundation managers who are members of a group (such as the foundation's board of directors or trustees) which is so authorized. For the definition of the term "foundation manager", see section 4946(b) and the regulations thereunder.

(ii) Agreement. The agreement of any foundation manager to the making of a taxable expenditure shall consist of any manifestation of approval of the expenditure which is sufficient to constitute an exercise of the foundation manager's authority to approve, or to exercise discretion in recommending approval of, the making of the expenditure by the

Reg. §53.4945-4(d) continued

(3) **Internal Revenue Service action on request for approval of grant procedures.** If, by the 45th day after a request for approval of grant procedures has been properly submitted to the Internal Revenue Service, the organization has not been notified that such procedures are not acceptable, such procedures shall be considered as approved from the date of submission until receipt of actual notice from the Internal Revenue Service that such procedures do not meet the requirements of this section. If a grant to an individual for a purpose described in section 4945(d)(3) is made after notification to the organization by the Internal Revenue Service that the procedures under which the grant is made are not acceptable, such grant is a taxable expenditure under this section.

(e) **Effective dates—(1) In general.** This section shall apply to all grants to individuals for travel, study or other similar purposes which are made by private foundations more than 90 days after October 30, 1972.

(2) **Transitional rules**—(i) Grants committed prior to January 1, 1970. Section 4945(d)(3) and (g) and this section shall not apply to a grant for section 170(c)(2)(B) purposes made on or after January 1, 1970, if the grant was made pursuant to a commitment entered into prior to such date, but only if such commitment was made in accordance with the foundation's usual practices and 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.

(ii) Grants awarded on or after January 1, 1970. In the case of a grant awarded on or after January 1, 1970, but prior to the expiration of 90 days after October 30, 1972, and paid within 48 months after the award of such grant, the requirements of section 4945(g) that an individual grant be awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in 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).

[¶34,951.30] Reg. §53.4945-5 Grants to organizations. (TD 7215, filed 10-30-72; amended by TD 7233, filed 12-20-72; TD 7290, filed 11-16-73.)

(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;

(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 any 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).

Reg. §53.4945-5(a) continued

(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 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. For purposes of this subdivision, a grant described herein 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 grant 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.

(ii) To governmental agencies. If a private foundation makes a grant to an organization described in section 170(c)(1) and such grant is 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.

Reg. §53.4945-5(b) continued

(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 pre-grant 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 pre-grant 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 reference 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 vilation 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 (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 pre-grant inquiry pursuant to this subparagraph.

Example (3). 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 pre-grant inquiry pursuant to this subparagraph.

Reg. §53.4945-5(b) continued

(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—

(i) 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,

(ii) 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,

(iii) 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

(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, 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).

Reg. §53.4945-5(b) continued

(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 for 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—(i) Transfers of assets described in section 507(b)(2). For rules relating to the extent to which the expenditure responsibility rules contained in sections 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)(ii)(f), and 1.507-3(a)(9).

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

(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 grant is otherwise terminated. 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 two 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.

Reg. §53.4945-5(c) continued

(3) **Grantees, accounting and record keeping 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 record-keeping 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 the Internal Revenue Service by grantor—(1) In general.** To satisfy the report-making 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, and

(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.

Reg. §53.4945-5(d) continued

(3) Record-keeping 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 the 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 [1] 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, 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 (for example, the income diverted in the case of an endowment grant, or the rental value of capital equipment for the period of time for which diverted) plus the amount of any further payments for the same grantee. However, if the foundation complies with the requirements of (a) of this subdivision but not the requirements of (b) of this subdivision, the amount of the taxable expenditure shall be the amount of such further payments.

(iv) In cases where a grantee has previously diverted funds received from a grantor foundation, and the grantor foundation determines that any part of a grant has again

[Footnote ¶34,951.30] Matter in *italics* added by TD 7290, which struck out:
(1) "(Form 990)"

Reg. §53.4945-5(e)(1)(iv) continued

been used for improper purposes, the foundation will not be treated as having made a taxable expenditure solely by reason of such diversion so long as the foundation—

(a) Is taking all reasonable and appropriate steps to recover the grant funds or to insure the restoration of the diverted funds and the dedication (consistent with the requirements of (b)(2) and (3) of this subdivision) of 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 further payments until—

(1) Such funds are in fact so recovered or restored,

(2) It has received the grantee's assurances that future diversions will not occur, and

(3) It requires 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. However, if the foundation complies with the requirements of (a) of this subdivision, but fails to withhold further payments until the requirements of (b) of this subdivision are met, the amount of the taxable expenditure shall be the amount of such further payments.

(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) **Grantees' 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 finished.

(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 pre-grant 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, Reg. §53.4945-5(f)(2)(i) continued

(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.

[¶34,951.35] Reg. §53.4945-6 Expenditures for noncharitable purposes. (TD 7215, filed 10-30-72; amended by TD 7233, filed 12-20-72.)

(a) **In general.** Under section 4945(d)(5) the term "taxable expenditure" includes any amount paid or incurred by a private foundation for any purpose other than one specified in section 170(c)(2)(B). Thus, ordinarily only an expenditure for an activity which, if it were a substantial part of the organization's total activities, would cause loss of tax exemption is a taxable expenditure under section 4945(d)(5). For purposes of this section and §§53.4945-1 through 53.4945-5, the term "purposes described in section 170(c)(2)(B)" shall be treated as including purposes described in section 170(c)(2)(B) whether or not carried out by an organization described in section 170(c).

(b) **Particular expenditures.** (1) The following types of expenditures ordinarily will not be treated as taxable expenditures under section 4945(d)(5):

(i) Expenditures to acquire investments entered into for the purpose of obtaining income or funds to be used in furtherance of purposes described in section 170(c)(2)(B),

(ii) Reasonable expenses with respect to investments described in subdivision (i) of this subparagraph,

(iii) Payment of taxes,

(iv) Any expenses which qualify as deductions in the computation of unrelated business income tax under section 511,

(v) Any payment which constitutes a qualifying distribution under section 4942(g) or an allowable deduction under section 4940,

(vi) Reasonable expenditures to evaluate, acquire, modify, and dispose of program-related investments, or

(vii) Business expenditures by the recipient of a program related investment.

(2) Conversely, any expenditures for unreasonable administrative expenses, including compensation, consultant fees and other fees for services rendered, will ordinarily be taxable expenditures under section 4945(d)(5) unless the foundation can demonstrate that

Reg. §53.4945-6(b)(2) continued

such expenses were paid or incurred in the good faith belief that they were reasonable and that the payment or incurrence of such expenses in such amounts was consistent with ordinary business care and prudence. The determination whether an expenditure is unreasonable shall depend upon the facts and circumstances of the particular case.

(c) Grants to "noncharitable" organizations—(1) In general. Since a private foundation cannot make an expenditure for a purpose other than a purpose described in section 170(c)(2)(B), a private foundation may not make a grant to an organization other than an organization described in section 501(c)(3) unless

(i) The making of the grant itself constitutes a direct charitable act or the making of a program-related investment, or

(ii) Through compliance with the requirements of subparagraph (2) of this paragraph, the grantor is reasonably assured that the grant will be used exclusively for purposes described in section 170(c)(2)(B).

For purposes of this paragraph, an organization treated as a section 509(a)(1) organization under §53.4945-5(a)(4) shall be treated as an organization described in section 501(c)(3).

(2) Grants other than transfers of assets described in §1.507-3(c)(1). (i) If a private foundation makes a grant which is not a transfer of assets pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization or reorganization to any organization other than an organization described in section 501(c)(3) (except an organization described in section 509(a)(4)), the grantor is reasonably assured (within the meaning of subparagraph (1)(ii) of this paragraph) that the grant will be used exclusively for purposes described in section 170(c)(2)(B) only if the grantee organization agrees to maintain and, during the period in which any portion of such grant funds remain unexpended, does continuously maintain the grant funds (or other assets transferred) in a separate fund dedicated to one or more purposes described in section 170(c)(2)(B). The grantor of a grant described in this paragraph must also comply with the expenditure responsibility provisions contained in sections 4945(d) and (h) and §53.4945-5.

(ii) For purposes of this paragraph, a foreign organization which does not have a ruling or determination letter that it is an organization described in section 501(c)(3) (other than section 509(a)(4)) will be treated as an organization described in section 501(c)(3) (other than section 509(a)(4)) if in the reasonable judgment of a foundation manager of the transferor private foundation, the grantee organization is an organization described in section 501(c)(3) (other than section 509(a)(4)). The term "reasonable judgment" shall be given its generally accepted legal sense within the outlines developed by judicial decisions in the law of trusts.

(3) Transfers of assets described in §1.507-3(c)(1). If a private foundation makes a transfer of assets (other than a transfer described in subparagraph (1)(i) of this paragraph) pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization to any person, the transferred assets will not be considered used exclusively for purposes described in section 170(c)(2)(B) unless the assets are transferred to a fund or organization described in section 501(c)(3) (other than an organization described in section 509(a)(4)) or treated as so described under section 4947(a)(1).

CASES AND RULINGS BY ISSUE

	Paragraph [¶]
Taxable expenditures	**34,952**
(5) Unconditional grants to individuals	
(7) Lobbying	
(10) Grants for study—in general	
(15) Exempt scholarships and prizes	
(20) Employer-related grants for study	
(25) Grants for study—specific objectives	
(35) Payments for services	
(40) Relation to self dealing	
(45) Expenditure responsibility	
(55) Return of contribution	
(60) Distribution to exempt company	
(65) Consequences of grant program disapproval	

[Footnote ¶34,951.35] Matter in *italics* added by TD 7233.

Worksheet 6—Contd.

tions, or to undertake any nonexempt activity, when such use of the funds would be a taxable expenditure if made directly by the foundation.

Terms of program-related investment. To meet the expenditure responsibility requirements in making a program-related investment, a private foundation must require that each investment be made subject to a written commitment signed by an appropriate officer, director, or trustee of the recipient organization.

The commitment should specify the purpose of the investment and should contain an agreement by the organization—

1) To use all amounts received from the private foundation only for the purposes of the investment and to repay any amount not used for those purposes within the limitations concerning distributions to holders of equity interests,
2) To submit a full and complete annual financial report of the type ordinarily required by commercial investors under similiar circumstances and a statement that it has complied with the terms of the investment,
3) To keep adequate books and records and to make them available to the private foundation at reasonable times, and
4) Not to use any of the funds to carry on propaganda, influence legislation, influence the outcome of any public elections, carry on voter registration drives, or to make grants that do not comply with the requirements regarding individual grants or expenditure responsibility when the recipient is a private foundation.

Certain grants to foreign organizations. Grants made to foreign organizations, other than an organization described in section 509(a)(1), (2), or (3), are subject to the same restrictions on the use of the grant as those imposed on domestic private foundations. These 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 the same restrictions on the use of the grant as those imposed on a domestic private foundation.

Special rules for grants by foreign private foundations. The failure of a foreign private foundation to comply with the restrictions imposed on grants will not constitute an act or failure to act that is a prohibited transaction under section 4948(c) of the Code.

Reports from grantees. The granting private foundation must 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 must make an annual accounting of the funds at the end of its accounting period and must make a final report on all expenditures made from the funds in addition to the progress made toward the goals of the grant.

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 showing the information that the grantor must submit to the Internal Revenue Service.

Recordkeeping requirements. In addition to the information required when filing a return, the granting foundation must make available to the Internal Revenue Service at its main office each of the following items:

1) A copy of the agreement covering each expenditure responsibility grant made during the year,
2) A copy of each report received during the tax year for each grantee on any expenditure responsibility grant, and
3) A copy of each report made by the grantor's personnel or independent auditors of any audits or other investigations made during the tax year on any expenditure responsibility grant.

Violations of expenditure responsibility requirements. Any diversion of grant funds (including income from an endowment grant) for a use not specified in the grant may result in that part of the grant being treated as a taxable expenditure. If the use of the funds is consistent with the purpose of the grant, the fact that a grantee does not use any funds as indicated in the original budget projection is not a diversion of funds.

If a grantor foundation determined that any part of the grant was 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 if it:

1) Takes all reasonable and appropriate steps either to recover the grant funds or to ensure the restoration of the diverted funds and the dedication of the other grant funds held by the grantee to the purposes of the grant, and
2) Withholds any further payments to the grantee, after being made aware that a diversion of funds may have taken place, until it has received the grantee's assurance that future diversions will not occur and required the grantee to take all precautions to prevent further diversions from occurring.

If a foundation is considered to have made a taxable expenditure, the amount of the taxable expenditure can be the amount of the diversion plus any further payments, or just the amount of further payments depending on the measure of compliance by the foundation.

Grantee's failure to make reports. A failure to make the required reports by the grantee will result in the grant being treated as a taxable expenditure by the grantor unless the grantor:

1) Awarded the grant according to the expenditure responsibility requirements discussed earlier,
2) Complied with all the reporting requirements,
3) Made a reasonable effort to get the required reports, and
4) Withholds all future payments on this grant and on any other grant to the same grantee until the report is provided.

Violations by the grantor. In addition to the circumstances discussed earlier concerning taxable expenditures, a granting foundation will be treated as making a taxable expenditure if it:

1) Fails to make a pre-grant inquiry,
2) Fails to obtain the required written commitments described earlier, or
3) Fails to make reports to the Internal Revenue Service as discussed earlier.

The reports to the Internal Revenue Service by the foundation on each expenditure responsibility grant must be made each year that any part of the grant remains unexpended by the grantee at any time during the year. The required reports must be submitted with the organization's annual return (Form 990–PF or Form 5227). They must include the following information on each grant:

1) The name and address of the grantee,
2) The date and amount of the grant,
3) The purpose of the grant,
4) The amounts spent by the grantee (based on the most recent report received from the grantee),
5) Whether, to the knowledge of the grantor foundation, the grantee has diverted any funds from the purpose of the grant,
6) The dates of any reports received from the grantee, and
7) The date and results of any verification of the grantee's reports undertaken by or at the direction of the grantor foundation.

Particular expenditures. Examples of expenditures ordinarily not treated as taxable expenditures include:

1) Expenditures to acquire investments that generate income to be used to further the purposes of the organization,
2) Reasonable expenses related to acquiring these investments,
3) Payment of taxes,
4) Expenses that qualify as allowable deductions in figuring the tax on unrelated business income,
5) Any payment that is a qualifying distribution,
6) Any deduction allowed in arriving at taxable net investment income,
7) Reasonable expenditures to evaluate, acquire, modify, and dispose of program-related investments, and
8) Business expenses of the recipient of a program-related investment.

However, payment of unreasonable administrative expenses, including wages, consultant fees and other fees for services performed, ordinarily will be taxable expenditures unless made by the foundation in the good faith belief that the amounts were reasonable and were consistent with ordinary business care and prudence.

Grants to noncharitable organizations. A private foundation cannot make a grant for a purpose not described in section 170(c)(2)(B). Permitted purposes are religious, charitable, scientific, testing for public safety, literary or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve providing athletic facilities or equipment), or for the prevention of cruelty to children or animals. Section 501(c)(3) describes organizations that are organized and operated exclusively for these purposes. Grants for nonpermitted purposes are taxable expenditures.

Accordingly, a private foundation may not make a grant to an organization that is not described in section 501(c)(3) unless, making the grant itself is a direct charitable act or a program-related investment, or the grantor is reasonably assured that the grant will be used exclusively for the purposes of an organization described here.