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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: MAR 20 2003

Contact Person:

Identification Number:

Telephone Number:

T:ED:B2

Uniform Issue List: 501.03-02
4945.04-06
6001.03-00

Employer Identification Number:

Legend:

M =

Dear Sir or Madam:

We have considered your letter dated March 25, 2002, as supplemented by your letter of February 26, 2003, in which you requested a ruling concerning the application of section 1.6001-1 of the Income Tax Regulations and section 4945 of the Internal Revenue Code and the regulations thereunder to the facts set out below.

Facts:

You are a private, grantmaking foundation. You are recognized as tax-exempt under section 501(c)(3) of the Code and as a private foundation under section 509(a).

In furtherance of your mission, you intend to expand your grantmaking programs in support of a diverse array of projects. These programs could include the making of loans or grants to public and non-public charities, expenditure control grants, program-related investments, and other disbursements. In the interests of greater efficiency, and with a view to streamlining your operations, you intend to conduct all of your charitable and grantmaking activities, administration, and grant award transactions electronically, including the disbursement of grant funds, loans, and other disbursements, and to originate and maintain all books and records pertaining to your operations electronically, including the tracking of your investments, charitable activities, and all other matters.

You have a general policy of not accepting unsolicited requests for support. Because it is your intention to consider only internally-generated initiatives and grants for funding, you will typically begin retaining electronic communications relating to grant making after your grant officer initiates the contact process to solicit a proposal from a potential grantee. The grant file would begin with the proposal and would include only electronic communications (or paper communications converted to electronic format) that materially modify or clarify the terms and

provisions of the grant. Each grant file will also contain a "grant summary" that describes the terms of the grant, the expected outcomes of the grant, the milestones to those outcomes to be evaluated, the results of any financial, legal, or other due diligence, and any special conditions of the grant.

All correspondence between grantee organizations and other recipients of your funds will be conducted by e-mail. Grant applicants will be able to download a formal grant application from your web site, complete and sign the application electronically, and return it to you by e-mail. Grant agreements will be signed electronically by the appropriate officer, director, or trustee of the grantee organization by electronic signature and returned to you by e-mail. For purposes of complying with the written grant commitment agreement and signature requirements, you will follow M law which permits the use of electronic records and signatures in most contracts and other writings of legal significance.

Grantees and other recipients of your funds will be permitted to submit to you all annual, semi-annual, and final reports, expenditure reports, and any other reports that may be required, in electronic form by e-mail. You will require that reports contain the name of the organization, the name of the individual making the report, his or her organizational title, contact information, the date of the report, and the accounting period to which the report corresponds, in addition to appropriate information regarding the uses made of your funds.

You will generate complete records with respect to your charitable activities and all grants, loans, program-related investments, and other disbursements electronically and retain such records in electronic form. The electronic records will contain all of the information that is required to be contained in hard-copy books and records. These records shall include all information you obtain to evaluate grant applicants, including the identification of individuals authorized to sign on behalf of the grantee organization; the completed application of each applicant; the executed grant agreement pertaining to each grant awarded; the amount of each grant and records pertaining to the disbursement of funds; all expenditure, progress, and final reports received from grantees; and any additional information that you have obtained in the course of the grant administration process.

You will retain all electronic records in an electronic medium for a period of time sufficient to substantiate your compliance with federal tax law. You will make the records available to the Service upon request. While you intend to conduct your charitable activities in an electronic format, you will retain the capability to conduct on-site investigations and reviews of the uses made of your funds. You will continue to file your annual return, Form 990-PF, in paper format until the Service adopts electronic filing of Form 990-PF.

Ruling Requested:

You request a ruling that books and records relating to your grantmaking operations, administration, and investments, including the awarding of grants, loans, program-related investments, and other disbursements and transactions, may be originated and maintained in electronic form to meet the requirements of section 1.6001-1 of the regulations for purposes of establishing continued entitlement to exempt status under section 501(c)(3) of the Code and

compliance with the private foundation excise tax provisions of Chapter 42 of the Code, including section 4945.

Law:

Section 1.6001-1(a) of the Income Tax Regulations provides that, generally, any person subject to tax under subtitle A of the Code (including the tax imposed by section 511 on unrelated business income of certain exempt organizations), or any person required to file a return of information with respect to income, shall keep such permanent books of account or records as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any return of such tax or information.

Section 1.6001-1(c) of the regulations provides that every organization exempt from tax under section 501(c) shall keep such permanent books of account or records, including inventories, as are sufficient to show specifically the items of gross income, receipts, and disbursements. Such organizations shall also keep such books and records as are required to substantiate the information required by section 6033.

Section 6033 of the Internal Revenue Code provides that every organization exempt from tax under section 501(a) must file an annual return, stating specifically the items of gross income, receipts and disbursements, and such other information and keep such records as the Secretary may prescribe.

Section 4945(a)(1) of the Code imposes a tax on private foundations for each taxable expenditure.

Section 4945(d)(4) of the Code provides that the term "taxable expenditure" means any amount paid or incurred by a private foundations as a grant to an organization unless (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 section 4945(h).

Section 4945(h) of the Code provides that the expenditure responsibility referred to in section 4945(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.

Section 53.4945-5(b)(1) of the Foundation and Similar Excise Taxes Regulations provides that 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.

Section 53.4945-5(b)(2)(i) of the regulations provides that before making a grant to an organization with respect to which expenditure responsibility must be exercised, a private foundation should conduct a limited inquiry concerning the potential grantee. Such inquiry should be complete enough to give a reasonable person assurance that the grantee will use the grant for proper purposes.

Section 53.4945-5(b)(3) of the regulations provides that, in order to meet the expenditure responsibility requirements of section 4945(h) of the Code, a private foundation must require that each grant to an organization, with respect to which expenditure responsibility must be exercised, 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 funds are spent and the progress made in accomplishing the purposes of the grant, (iii) to maintain records of receipts and expenditures and to make its books available to the grantor at reasonable times, and (iv) not use any of the funds to influence legislation or the outcome of any specific public election, or to undertake any activity for any purpose other than one specified in section 170(c)(2)(B) of the Code.

Section 53.4945-5(b)(4) of the regulations provides that, 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 only for the purposes of the investment and to repay any portion not used for such purposes; (ii) at least once a year during the existence of the program-related investment, to submit full and complete financial reports 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 to carry on propaganda or to influence the outcome of any specific public election.

Section 53.4945-5(c) of the regulations provides, generally, that in the case of grants described in section 4945(d)(4) of the Code, 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.

Section 53.4945-5(d)(1) of the regulations provides, generally, that 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).

Section 53.4945-5(d)(2) of the regulations provides that the report required by section 53.4945-5(d)(1) 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; (v) whether the grantee has diverted any portion of the funds from the purpose of the grant; (vi) the dates of any reports received from the grantee; and (vii) the date and results of any verification of the grantee's reports.

Section 53.4945-5(d)(3) of the regulations provides that in addition to the information included on the information return, a granting foundation shall make available to the 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 auditor of any audits or other investigations made during the taxable year with respect to any "expenditure responsibility" grant.

Rev. Rul. 71-20, 1971-1 C.B. 392, holds that punched cards, magnetic tapes, disks, and other machine sensitive data media used for recording, consolidating, and summarizing accounting transactions and records within a taxpayer's automatic data processing system are records within the meaning of section 6001 of the Code and section 1.6001-1 of the regulations and are required to be retained so long as the contents may become material in the administration of any internal revenue law.

Rev. Proc. 98-25, 1998-1 C.B. 689, sets out the basic requirements that the Service considers essential in cases where a taxpayer's records are maintained within an Automatic Data Processing (ADP) system. The requirements pertain to all matters under the jurisdiction of the Commissioner including income and excise taxes, as well as exempt organizations. The requirements are applicable to any sections of the Code that have unique or specific recordkeeping requirements. Except as otherwise provided in this revenue procedure, all requirements of section 6001 of the Code that apply to hardcopy books and records apply as well to machine-sensible books and records within an ADP system.

Section 5.01 of Rev. Proc. 98-25 provides that, in general, the taxpayer must retain machine-sensible records so long as their content may become material to the administration of the internal revenue laws under section 1.6001-1(e) of the regulations. The taxpayer's machine-sensible records must provide sufficient information to support and verify entries made on the taxpayer's return and to determine the correct tax liability. The taxpayer's machine-sensible records will meet this requirement only if they reconcile with the taxpayer's books and the taxpayer's return.

Section 5.03 of Rev. Proc. 98-25 provides that a taxpayer that uses EDI technology (defined as the computer-to-computer exchange of business information) must retain machine-sensible records that alone, or in combination with other records, contain all the information that section 6001 of the Code requires of hardcopy books and records. A taxpayer may capture the required detail for an EDI transaction at any level within its accounting system. However, the

taxpayer must establish audit trails between the retained records and the taxpayer's books, and between the retained records and the tax return.

Section 11 of Rev. Proc. 98-25 provides that this revenue procedure does not relieve taxpayers of their responsibility to retain hardcopy records that are created or received in the ordinary course of business as required by existing law and regulations. A taxpayer need not create or retain hardcopy records if the hardcopy records are not produced in the ordinary course of transacting business (as may be the case when utilizing EDI technology). A taxpayer need not create hardcopy printouts of its machine-sensible records unless requested to do so by the Service.

15 U.S.C.S. § 7001 (Electronic Signatures Act of 2000) provides that, notwithstanding any statute, regulation, or other rule of law, with respect to any transaction in or affecting interstate or foreign commerce: (1) a signature, contract, or other record relating to such transaction may not be denied legal effect, validity, or enforceability solely because it is in electronic form; and (2) a contract relating to such transaction may not be denied legal effect, validity, or enforceability solely because an electronic signature or electronic record was used in its formation.

12 U.S.C.S. § 7004 provides that nothing in this title (i.e., 15 U.S.C.S. §§ 7001 et seq.) limits or supersedes any requirement by a Federal regulatory agency that records be filed with such agency or organization in accordance with specified standards or formats.

M has adopted the Uniform Electronic Transactions Act, which provides that (a) a record or signature may not be denied legal effect or enforceability solely because it is in electronic form; (b) a contract may not be denied legal effect or enforceability solely because an electronic record was used in its formation; (c) if a law requires a record to be in writing, an electronic record satisfies the law; and (d) if a law requires a signature, an electronic signature satisfies the law.

Discussion:

Based on the information contained in your letters of March 25, 2002, and February 26, 2003, we conclude that the conduct of all grantmaking activities, administration, and grant award transactions electronically, and the origination and maintenance of books and records pertaining to your operations in electronic form as described in your letter, meets the recordkeeping requirements of section 6001 of the Code, and would not, in themselves, be a reason to find that you had not complied with the expenditure responsibility requirements under section 4945(h) of the Code.

Rev. Rul. 71-20 holds that electronic records used in recording, consolidating, and summarizing accounting transactions are "records" within the meaning of section 6001 of the Code. Furthermore, Rev. Proc. 98-25 acknowledges that taxpayers (including exempt organizations) may keep their books and records in electronic form so long as those records contain all the information that section 6001 requires of any hardcopy books and records. A taxpayer need not create or retain hardcopy records that are not produced in the ordinary

course of transacting business.

In the interests of greater efficiency, you intend to conduct all grantmaking activities, administration, and grant award transactions electronically, and to originate and maintain all books and records electronically. The electronic records will contain all of the information that is required to be contained in hardcopy books and records. Therefore, your recordkeeping procedures comply with the requirements of section 6001 of the Code.

Since Rev. Proc. 98-25 allows tax-exempt organizations to keep their books and records in electronic format, grantee applications, reports and other information pertaining to transactions that are kept in electronic form and transmitted to you by e-mail should comply with the reporting requirements of section 4945 of the Code provided such reports contain the information that is required.

Section 53.4945-5(b) of the regulations requires that each grant and each program-related investment with respect to which expenditure responsibility must be exercised be made subject to a written commitment signed by an appropriate officer of the grantee or recipient organization. The regulation does not specify any particular form of signature. The federal Electronic Signature Act of 2000 and the Uniform Electronic Transactions Act as adopted by M provide that a record or signature may not be denied legal effect or enforceability solely because it is in electronic form. Insofar as an electronic signature satisfies any law that requires a signature, a grant agreement signed by an electronic signature should be binding for purposes of section 4945 of the Code.

Conclusion:

Accordingly, based on the facts represented, we rule that books and records relating to your grantmaking operations, administration, and investments, including the awarding of grants, loans, program-related investments, and other disbursements and transactions, may be originated and maintained in electronic form to meet the requirements of section 1.6001-1 of the regulations for purposes of establishing continued entitlement to tax exempt status under section 501(c)(3) of the Code and compliance with the expenditure responsibility requirements under section 4945(h) of the Code.

Except as we have ruled above, we express no opinion as to the tax consequences of the transactions under the cited provisions of the Code or under any other provisions of the Code.

This ruling letter is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Because this ruling letter could help resolve any questions about the application of the Code to your activities, you should keep a copy of this ruling in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) Terrell M. Berkovsky

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2