International Charitable Giving: A Primer

Karen T. Schiele and Kaitlyn T. Wollman

International charitable activities, ranging from donations to physical operations, exist amid a complex legal landscape.

U.S. individuals and organizations increasingly have a global outlook, which has resulted in a global approach to charitable activities. Where an individual's giving is motivated, at least in part, by income or transfer tax consequences, the rules are clear about the permissibility of a charitable deduction. However, for domestic private foundations and public charities that engage in activities abroad or simply have international donees, the rules are far less straightforward. Such entities must ensure that they carefully comply with governmental regulations and monitor the specific activities for which they are sending funds abroad, at the risk of civil fines, criminal penalties, and various tax implications. Potential tax consequences range in severity from donations being deemed nondeductible to losing tax-exempt status entirely.

This article reviews the applicable rules and potential pitfalls for U.S. individuals and tax-exempt organizations seeking to benefit from charitable causes abroad.

CHARITABLE DEDUCTIONS FOR GIFTS MADE BY INDIVIDUALS

Income Tax. Pursuant to IRC Section 170(c)(2)(A), a contribution by an individual to a charitable organization will qualify for an income tax charitable deduction only if the organization is "created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States." Such organization must be "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals."[1] This encompasses the first thing that comes to mind on the subject of charitable gifts - the donation to the neighborhood animal shelter, contributions to the local church, annual giving to an alma mater, and so on. Each of these gifts, if made to an eligible nonprofit, would permit the donor to take a charitable deduction on the donor's annual income tax return.

On the other hand, according to the IRC provisions cited previously, a donation made directly to a foreign charitable organization would not qualify for an income tax deduction. Rather, individuals with international charitable intent who are also motivated by tax consequences may seek to donate to "friends of' organizations that benefit foreign charitable institutions (discussed further in a later section). Alternatively, the individual could utilize private foundations or donor-advised funds (also discussed in a later section) to make donations abroad. These alternatives would allow for both an international charitable beneficiary and an income tax deduction.

Estate Tax. In contrast to the income tax ruLes, for estate tax purposes, a donee charity need not be organized in the United States for a donation by a decedent to receive an estate tax charitable deduction. Generally speaking, an estate tax charitable deduction will be allowed where a bequest or transfer is made to a qualifying recipient for charitable, religious, or other similar purposes.[2]

The IRS does, however, require that the use of contributions to foreign organizations be limited to only charitable purposes. Estates may receive an estate tax charitable deduction for a gift to a foreign charity if the requirements of IRC Section 2055(a) and Treasury Regulation Section 20.2055-1 are met. In particular:

1. The recipient entity must be a corporation or association.
2. The recipient entity must be organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes.
3. No part of the distributions from the recipient entity may inure to the benefit of any private shareholder or individual other than those to whom distributions are made pursuant to the governing instrument of the entity.
4. The recipient entity may not participate in political campaign activities on behalf of or in opposition to any candidate for public office.
5. The recipient entity may not engage in any lobbying activities or other attempts to influence legislation.
6. The recipient entity must maintain its exempt status in its incorporating country.[3]

If the foreign organization meets the aforementioned requirements, a decedent's bequest or transfer could be deducted on the Form 706 Estate Tax Return.

Gift Tax. Likewise, for gift tax purposes, a charitable deduction is not limited to gifts to domestic charitable organizations. Treasury Regulation Section 25.2522(a)-l(a)(4) states, "The deduction is not limited to gifts for use within the United States, or to gifts to or for the use of domestic corporations, trusts, community chests, funds, or foundations, or fraternal societies, orders, or associations operating under the lodge system." The gift tax charitable deduction is allowed for donations to international organizations only if the following requirements are met:

1. It must be organized and operated exclusively for religious charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals.

Karen T. Schiele *is a partner in Carter Ledyard & Milburn LLP, a law firm in New York City.*

Kaitlyn Wollman *is an associate at Carter Ledyard & Milburn LLP, a law firm in New York City.*

Ms. Schiele and Ms. Wollman *focus their practices on all aspects of trusts and estates, from estate planning and probate to estate litigation.*

2. It must not be disqualified for tax exemption under Section 50l(c)(3) by reason of attempting to influence legislation.
3. In the case of gifts made after December 31, 1969, it must not participate in, or intervene in (includ- ing the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.
4. Its net earnings must not inure in whole or in part to the benefit of private shareholders or individuals other than as legitimate objects of the exempt purposes.[4]

Donations made to organizations that comply with the aforementioned requirements would be eligible for deduction on the donor's Form 709 Gift Tax Return.

TAX-EXEMPT ORGANIZATIONS GIVING FUNDS TO FOREIGN ORGANIZATIONS FOR CHARITABLE PURPOSES

Private Foundations. One vehicle for individuals seeking to benefit charitable causes abroad is the private foundation. To avoid excise taxes, a private foundation must make a minimum amount of "qualifying distributions" annually and avoid making taxable expenditures. A private foundation may treat grants to a foreign organization as qualifying distributions that satisfy the distribution requirements of Section 4942 of the IRC if (1) the foreign organization is equivalent to a U.S. public charity, or (2) an equivalency determination has been made with respect to such foreign charity.

If the foreign organization has received a determination letter from the IRS that it is a public charity or a private operating foundation,[5] then the test to consider the grant a qualifying distribution is met. Where a foreign organization does not have such a determination letter, a domestic pri- vate foundation can make an equivalency determination with respect to the foreign organization to meet the test.[6] Revenue Procedure 2017-53 states that the domestic private foundation must make a good faith determination that the grantee is (1) a Section 50l(c)(3) organization, other than by reason of Section 509(a)(4), and (2) a qualifying public charity for purposes of Sections 4942(g) and 4945(d)(4), providing detailed guidelines about the sources of information that can be relied upon to make such good faith determinations.

To avoid excise taxes, a private foundation must make a minimum amount of "qualifying distributions" annually and avoid making taxable expenditures.

Where a private foundation does not meet the requirements to treat a distribution to a foreign charity as a qualifying distribution, it may treat such a distribution as an expenditure subject to the expenditure responsibility guidelines. The guidelines provided by the IRS are as follows:

1. to see that the grant is spent only for the purpose for which it is made;
2. to obtain full and complete reports from the grantee organization on how the funds are spent; and
3. to make full and detailed reports on the expenditures to the IRS.

If the aforementioned guidelines are followed, the private foundation will not incur an excise tax by reason of the grant to the foreign charity.

Donor-advised Funds. A donor-advised fund is another option for individuals seeking to make international charitable donations. Unlike private foundations, a donor-advised fund is not obligated to make donations on an annual basis.

A donor-advised fund is beholden to the same requirements as a private foundation regarding donations abroad. If the foreign organization has not received a determination letter from the IRS, the donor-advised fund will be required to make an equivalency determination[7] or exercise expenditure responsibility, subject to the aforementioned guidelines.

Donor-advised funds are maintained and operated by sponsoring organizations, which may have their own restrictions on international giving. Therefore, individuals seeking to benefit charities abroad should confirm that their intended class of donee would be acceptable to the sponsoring organization.

Public Charities Soliciting Funds on Behalf of Foreign Organizations. A third alternative for benefitting foreign charitable causes is by donating to a public charity. Often, public charities are organized in the United States but seek largely to benefit organizations operating overseas. These domestic nonprofits are commonly called "friends of" organizations.[8] Where a public charity solicits funds in the United States on behalf of a foreign organization for the foreign organization's purposes, several revenue rulings provide guidelines for determining whether the domestic organization exercises sufficient control to allow contributions to be deductible for income tax purposes under Section 170(c).

Revenue Ruling 63-252 sets forth the rule that grants to a domestic organization are not deductible for income tax purposes if they are earmarked for a foreign organization. On the other hand, contributions to a domestic organization that are subject to the domestic organization's sole control, but may subsequently be transmitted to a foreign organization, may be deductible. This subtle factual difference is determinative according to the Revenue Ruling.

Revenue Ruling 68-489 provides that an organization exempt from taxation under Section 50l(c)(3) does not risk its exempt status by distributing funds to organizations that are not likewise exempt from taxation. This is true so long as the exempt organization (1) retains control and discretion as to the use of the funds; (2) maintains records establishing that the funds were used for Section 50l(c)(3) purposes; and (3) limits distributions to specific projects that are in furtherance of its own exempt purposes. Similarly, Revenue Ruling 56-304 provides that an organization exempt from taxation under Section 50l(c)(3) is not precluded from making distributions of funds to indi- viduals as opposed to entities, "provided such distributions are made on a true chari- table basis in furtherance of the purposes for which they are organized."

Revenue Ruling 66-79 provides several factors that indicate whether the domestic corporation has the requisite discretion and control over the funds it receives and transfers to a foreign organization, including:

> that the governing instruments of the domestic organization provide that making grants is in the exclusive power of the organization's board of directors;

that the board of directors require grantees to furnish a periodic accounting regarding the use of the funds granted to the grantees by the organization;

that the board of directors have the discretion to refuse to make grants to or for any or all of the purposes for which funds are requested; and

that the public charity make these policies known to donors upon request and refuse to accept contributions earmarked so that they must go to the foreign organization.

In sum, a nonprofit must exercise reasonable care to ensure that its assets are used for charitable purposes. A charity can demonstrate that it exercised this care by maintaining procedures for properly vetting a foreign grantee, such as:

requiring a written application from the grantee and conducting background checks;

entering into an agreement with the foreign grantee that sets forth the purpose of the grant; and

exercising oversight of the grant to ensure the grant is used as intended.

A charity's exempt status can be revoked if the charity makes grants to foreign organizations and it cannot demonstrate that the grants were actually used for exempt purposes.

GOVERNMENTAL COMPLIANCE WHEN CONDUCTING CHARITABLE ACTIVITIES ABROAD

For an organization to be tax exempt under Section 50l(c)(3) of the IRC, its purposes must be charitable - the location where the charitable activities are conducted is irrelevant. However, where an organization is operating some or all of its programs physically in a foreign country, there are various compliance concerns to consider.

Charities engaging in direct activity abroad should be mindful of sanctions programs set forth by the Treasury Department's Office of Foreign Asset Control ("OFAC"). OFAC restricts programs that may be operated in certain countries. In some cases, a special license may be required for a charity to conduct specific activities. OFAC forbids transactions with specific named individuals and organizations, known as Specifically Designated Nationals. A list of these individuals' names is available on the OFAC website. Violations of these programs can lead to civil fines and criminal penalties, so organizations should be sure to always confirm compliance with OFAC when operating abroad.

In addition, charities must be wary of involvement with a country that the United States has designated as a State Sponsor of Terrorism (presently Cuba, North Korea, Iran, and Syria). The U.S. Department of State requires a special license if an organization is engaging in activities in these countries.

Additional tax filings should be anticipated for tax-exempt organizations engaging in charitable activities abroad, both for operations in the host country and contributions to a foreign donee. If the foreign activities are completed during the first three years that the organization is in operation, the organization should anticipate additional inquiries on the Form 1023 Application for Tax-exempt Status. If the activities are completed later in the organization's tenure, no adjustments to the Form 1023 are required. However, thorough record keeping should be maintained in case of an audit.

Form 990 Schedule F Statement of Activities Outside the United States should also be filed to report foreign activities annually. If the organization has a financial interest or signature authority over a foreign financial account, and the value exceeds $10,000 at any time, the organization will also be expected to file Form 90-22.1.

Finally, charities might be required to register with the host country for certain activities, depending on the country's requirements. Charities should consider the laws of the host country as they pertain to employment, contracts, and business operations, especially if non-U.S. individuals will be employed over the course of the charitable operations abroad. It may be beneficial to work with a local attorney to guide the organization through local laws and regulations.

CONCLUSION

International charitable activities, ranging from donations to physical operations, exist amid a complex legal landscape. However, with strategic tax, legal, and compliance planning, a donor's charitable intent can be effectuated to the benefit of all involved.

End Notes

IRC Section 170(c)(2)(B).

[2] §2055(a); Reg. §20.2055-1.

[3] See, Private Letter Ruling 9821044.

Tres. Reg. 25.2522(a)-l(a)(2).

Rev. Proc. 92-94, 1992-2 C.B. 507. Updatecl by Rev. Proc. 2017-53.

[6] Treas. Regs. §§53.4942(a)-3(a)(6), 53.4945-5(a)(5), and 53.4945-6(c)(2)(ii).

[7] Treas. Regs. §§53.4942(a)-3(a)(6), 53.4945-5(a)(5), and 53.4945-6(c)(2)(ii).

[8] See Rev. Rul. 67-149, 1967-1C.B.13311. The organization"... carries on no operations other than to receive contributions and incidental investment income and to make distributions of income to such exempt organizations at periodic intervals."