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ARTICLE

International Philanthropy: Considerations for the Globally Minded Donor

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Many of our clients are interested in engaging in global philanthropy. These individuals often want to benefit charitable causes outside of the United States while still being able to maintain an income tax deduction for United States income tax purposes in connection with their donations.

Generally, other than exceptions for specific tax treaties, a United States individual cannot obtain an income tax charitable deduction for donations made to foreign charitable organizations or domestic organizations that are mere conduits for foreign charitable organizations. However, there are options available to United States taxpayers to participate in international philanthropy while maintaining the charitable deduction for United States income tax purposes.

Individuals with charitable intentions who wish to make an impact or begin their philanthropic legacies during their lifetimes often seek to maximize the benefits of their charitable contributions by deducting qualifying charitable contributions on their income tax returns. In order to take advantage of the charitable deduction, individuals must itemize their deductions for the year in which they made such charitable contributions on their federal income tax return. Pursuant to the Internal Revenue Code (I.R.C.), many contributions by an individual to a variety of charitable organizations, such as public charities and select private foundations, are fully deductible against such individual's adjusted gross income to the extent that the aggregate of such charitable contributions does not exceed 50% of such individual's contribution base[1] for the taxable year.[2] A charitable contribution for United States income tax purposes is defined, in part, as a contribution or gift to or for the use of a corporation, trust, or community chest, fund or foundation that is (1) created or organized in the United States; (2) organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, or to foster national or international sports competition[3] or for the prevention of cruelty to children or animals; (3) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and (4) is not disqualified for tax exemption under I.R.C. § 501(c)(3) by

reason of attempting to influence legislation, and which does not participate in, or intervene in, any political campaign on behalf of or in opposition to any candidate for public office.[4]

Due to the requirement that the donee organization must be created or organized in the United States in order for an individual's contribution to qualify for an income tax deduction, many contributions to foreign charitable organizations are not deductible against such individual's adjusted gross income. However, notably absent from the I.R.C. is a requirement that funds received by a charitable organization be used for the public benefit of individuals or causes within the United States. Therefore, there are strategies available to those individuals who wish to make charitable contributions that have an international impact while maintaining the ability to deduct such qualifying charitable contributions on their United States income tax returns.

Direct Contributions

Generally, contributions made directly by individuals to foreign organizations are not deductible for United States income tax purposes due to the requirement that a charitable contribution must be made to an organization that is created or organized in the United States.[5] However, some foreign charities in Canada, Mexico and Israel have received United States tax-exempt status in accordance with I.R.C. § 501(c)(3). Keeping in mind that the United States taxes its tax residents on the totality of such individuals' worldwide income, pursuant to the United States' tax treaties with each of Canada, Mexico and Israel, individuals who have foreign-sourced income from such countries may make tax-deductible charitable contributions, with certain limitations, to tax-exempt organizations established in the same foreign country as such foreign-sourced income.[6] This results in a permitted income tax deduction for such individuals pursuant to the relevant tax treaty. From a practical perspective, the Internal Revenue Service (IRS) maintains a database of foreign organizations that are currently tax-exempt in order to help donors determine the deductibility of any contributions, although an individual should always consult with a qualified tax practitioner prior to making any such charitable contributions.

American Friends of Foreign Charity

Many foreign charities that attract significant attention of donors in the United States will have a corresponding United States tax-exempt organization that is qualified as a domestic public charity pursuant to I.R.C. § 501(c)(3). Often, this United States based counterpart is named the "American Friends of" or "Friends of" the intended foreign charitable organization. Because the "Friends of" organization is created and established in the United States, contributions to such organization may qualify as tax-deductible provided, however, the other requirements discussed above for charitable contributions are also met.

These "Friends of" organizations are generally set up to support the foreign charitable organizations' work and missions abroad, although one must be careful that the "Friends of" organization is not a mere conduit for a foreign organization.[7] In order to qualify for a charitable deduction for United States income tax purposes, the "Friends of" organization must have full ownership and control over the assets contributed to it without being legally bound to distribute such funds to a foreign charitable organization.[8] The "Friends of" organization should also maintain two-way communication with the foreign charitable organization regarding its charitable activities to ensure that contributions to such first-mentioned organization will continue to be used for public benefit. As a result, donations to the "American Friends of" or "Friends of" a foreign charitable organization may qualify for the charitable deduction for United States income tax purposes.

Contribute to Domestic Charity With Foreign Subsidiary

Contributions may also be deducted by individuals for United States income tax purposes when such individuals make contributions to domestic public charities that have a controlled tax-exempt subsidiary in a foreign country for either administrative convenience or to administer its operations in such foreign country, even if the funds given by the individual to the domestic public charity are then transferred to the foreign subsidiary for its foreign charitable activities.[9] It is important to note that in order to maintain the charitable deduction for United States income tax purposes, such foreign subsidiary should be qualified as a charitable organization in the foreign jurisdiction and must be considered a disregarded entity of the United States-based parent public charity for United States tax purposes.[10] Because the foreign entity is disregarded for United States tax purposes, contributions to the foreign subsidiary would be considered donations to the United States-based parent public charity of which the foreign subsidiary is viewed as a branch or division of such parent. Key to the deductibility of the contribution is that the United States-based parent public charity must be in control of the entirety of the contribution.[11] One thing to be wary of is that, depending on the jurisdiction of the formation of the foreign subsidiary, such subsidiary may not be eligible to both qualify as a charitable organization in such foreign jurisdiction and make an election for United States tax purposes to be a disregarded entity.

Use a Private Foundation or Donor-Advised Fund

If a United States individual wants to make significant grants to foreign charities, the individual can establish a United States private foundation or contribute to a donor-advised fund (DAF). If the foreign charity has received a determination letter from the IRS recognizing that it meets the standards to qualify as a United States public charity, a United States private foundation or DAF can make distributions to the foreign charity without additional oversight required by the private foundation or DAF. Otherwise, in order to comply with United States requirements, the United States private foundation or DAF will be required to either (1) exercise expenditure responsibility with respect to the

grant or (2) make a good faith determination that the foreign charity is the equivalent of a United States public charity (an "equivalency determination").[12]

For foreign grantmaking, expenditure responsibility is the obligation to make sure that the funds of the private foundation or DAF are being used for purposes which would qualify for a United States income tax deduction if such funds had been contributed to a domestic public charity. In order to satisfy the requirements of expenditure responsibility, the private foundation or DAF must first conduct a pre-grant inquiry in order to determine whether the proposed grant will be used for charitable purposes. Subsequent to such inquiry, if the donor organization determines that the proposed grant would be used for charitable purposes, the donor organization must (1) enter into a written grant agreement with the foreign charitable organization that requires such organization to return any part of the grant which is not used for the stated charitable purposes; (2) exert all reasonable efforts and establish sufficient procedures to ascertain that the grant is only used for charitable purposes; (3) obtain full and complete reports from the recipient foreign charitable organization on how the grant is spent; and (4) provide full and detailed reports as to such contributions to the IRS.[13]

Alternatively, a United States private foundation or DAF may make distributions to a foreign organization that has not obtained tax-exempt status pursuant to I.R.C. § 501(c)(3) pursuant to a good faith equivalency determination.[14] Making an equivalency determination requires a qualified tax practitioner (i.e., an attorney, CPA or enrolled agent) to collect detailed information regarding the foreign charitable organization's finances, organization, governing documents and activities. An equivalency determination is made in good faith if it is based on written advice that is current and received from a qualified tax practitioner that concludes that the foreign charitable organization is the equivalent to a qualifying public charity.[15] There are several domestic organizations that maintain a database of foreign charitable organizations for which such organizations have already conducted the due diligence regarding an equivalency determination of the listed foreign charitable organizations and, for a fee, can provide an equivalency determination certificate to be used by a donor in good faith.

This option makes the most sense for United States individuals who are interested in providing ongoing support to foreign charities, since the start-up and administration costs of a private foundation can be significant, and most DAFs have a minimum contribution amount in order to move forward with foreign grantmaking.

Donate to a United States Intermediary Organization

United States individuals interested in making a onetime donation to a foreign charity, circumstances in which establishing a private foundation or DAF does not make sense, can donate instead to a

United States intermediary grantmaking organization. For a fee, which is generally a percentage of the donation amount, a United States individual can donate to a United States intermediary organization, obtain a charitable deduction for the donation, and the intermediary organization will conduct the necessary due diligence and distribute the donation to the desired foreign charity.[16]

Conclusion

While donations from individuals to foreign charitable organizations are often not deductible for United States income tax purposes, for the careful and informed donor, there are options available by which one can exercise one's global charitable intentions while maintaining the income tax deduction for United States income tax purposes. Whether it is by direct contribution to select foreign tax-exempt organizations or domestic organizations with foreign reach, or through contributions to a private foundation, DAF or United States intermediary organization, options remain available. An individual who wishes to have a charitable impact abroad should seek professional advice prior to making such charitable contributions if such individual wishes to retain the charitable deduction for such contribution for United States income tax purposes.

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1 An individual's contribution base for purposes of this section of the I.R.C. is such individual's adjusted gross income as computed without regard to any net operating loss carryback for the taxable year pursuant to I.R.C. § 172.

2 I.R.C. § 170(b)(1)(A).

3 Only if no part of such organization's activities involve the provision of athletic facilities or equipment.

4 I.R.C. § 170(c)(2).

5 I.R.C. § 170(c)(2)(A).

6 IRS Publication 526; The United States – Canada Income Tax Treaty, Article XXI; Notice 99-47; United States – Mexico Income Tax Convention, Article 22; Convention Between the Government of the United States of America and the Government of the State of Israel with Respect to Taxes on Income, Article 15-A.

7 Rev. Rul. 62-113.

8 Id.

9 Rev. Rul. 63-252; Rev. Rul. 66-79.

10 Id.

11 Id.

12 Rev. Proc. 2017-53.

13 I.R.C § 4945(h).

14 Rev. Proc. 2017-53.

15 Id.; Treas. Reg. § 53.4945-5(a)(5).

16 Examples of United States intermediary organizations that assist United States individuals with global grantmaking are CAFAmerica and National Philanthropic Trust.

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