QUALIFYING GIFTS TO CHARITIES OUTSIDE OF THE UNITED STATES FOR THE INCOME TAX CHARITABLE DEDUCTION

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Gift and Estate Tax Treatment

- Estate and gift tax charitable deductions are permitted when gifting/bequeathing to foreign charities.
- The contribution must be used for religious, scientific, literary or educational purposes or for the prevention of cruelty for animals.
- No limitations on amount deductible.
- Nonresident aliens subject to U.S. estate and gift tax on transfers are only allowed deductions for amounts passing to U.S. organized entities or to a trust where the assets will be used within the U.S.
Fiduciary Income Tax Treatment

- In general, a fiduciary income tax charitable deduction is permitted when a trust or estate makes distributions to foreign charities organized abroad in the year income is earned.
- Governing instrument must authorize distributions.
- No limitations apply to amount deductible.
- Amount paid must be traceable to gross income.
- Foreign organization must generally have applied for, or have already received, IRS 501(c)(3) status.
  - Exception: If foreign org. receives substantially all support from outside the U.S., 501(c)(3) status is not required.
- Things get thorny when distribution to charity occurs outside of year that income is earned.
Individual Income Tax Treatment

- Individual income tax deduction only permitted for contributions to U.S. organized charities.
- This is contrary to the rules previously discussed in other tax contexts.
- Notable Exceptions:
  - Corporate donations to corporations may be used abroad and still receive an income tax deduction.
  - Treaties
    - Canada
    - Mexico
    - Israel
Limitations on Donations

- 50% and 30% limits for public charities and operating private foundations.

- 30% and 20% limits for private foundations.

- 5 year carry forward for unused deductions.

- Special rules for tangible personal property.
Type of Charities

• Public charity
  o Support Test – 33\(\frac{1}{3}\)% support from general public; or
    o Facts and Circumstances Test – 10% support from general public and facts and circumstances show that entity acts like a public charity.

• Private foundation – does not meet either public charity test.

• Operating foundation – does not meet either public charity test but actively conducts substantially all of its own activities.
American Friends Organizations

- “American Friends” is a term of art and has no specific IRS classification.

- Key revenue rulings
  - Rev. Rul. 63-252 (1963-2 CB 1010)
  - Rev. Rul. 66-79 (1966-1 CB 48)

- Not required to use “American Friends” in name of charity.

- For structure to be respected, must not be deemed a conduit by IRS. If deemed a conduit, contributions deemed contributed directly to foreign charity and no income tax deduction.
Conduit Issues

• Discretion and Control by U.S. charity.

• Board Composition:
  o Not controlled by foreign charity.
  o Majority U.S. citizens or residents.

• Fundraising:
  o Can only solicit for preapproved projects going to foreign charity.
  o Cannot solicit for foreign charity in general.

• Earmarking:
  o Donor may not direct contribution use but may request.
  o U.S. charity must maintain discretion and control.
  o May direct for specific charitable purposes (not specific foreign organizations).
Grants

• Each grant request and approval should be reviewed by board of directors and documented.

• Grant agreement should be entered into with foreign charity detailing use of funds and oversight.

• General support grants are permissible.

• Though not required, use of expenditure responsibility standards is best practice.
Penalties

• If deemed conduit, no income tax deductions for U.S. donors.

• U.S. charity may lose exempt status. Taxed as corporation (or trust, depending) going forward, perhaps retroactive to effective date of revocation.

• Donors claiming income tax deductions for periods after effective revocation face increased taxes/penalties.
  o Donors may take deductions made before organization appears on IRS list of revoked organizations.
Fiscal Sponsorship

- Use existing charity to sponsor a foreign project.
- Donor advised funds.

Advantages:
- Administrative ease.
- No need for general public support.

Disadvantages:
- Not in control.
- Not willing accept certain assets.
- Costs and fees to utilize pre-existing organization.
Private Foundations Gifting Abroad

- Most foreign charities do not have IRS exemption letter.

- Need to avoid excise taxes on taxable expenditures and qualify distributions toward the 5% distribution test.

- Safe harbors:
  - Equivalency Determination; or
  - Expenditure Responsibility

- Expenditure Responsibility often the easier to administer.
Other Issues to Consider

- **OFAC – Office of Foreign Asset Control**
  - Maintains list of foreign countries and persons under sanctions.
  - Severe penalties for supporting.

- **FATF – Financial Actions Task Force**
  - Designed to protect against money laundering and terrorism.