International Taxation of Philanthropy

Removing Tax Obstacles for International Charities

CHAPTER 1
SUBJECT OF STUDY

1.1. Philanthropic organizations in western democratic society in the twenty-first century

In western democratic societies, the importance of philanthropic organizations is rapidly increasing. According to a study by the John Hopkins Comparative Non-profit Sector Project, a veritable "global associational revolution" appears to be under way – a massive upsurge of organized private, voluntary activity in virtually every region of the world. The rise of the civil society sector may, in fact, prove to be as significant a development of the late twentieth and early twenty-first centuries as the rise of the nation state was of the late nineteenth and early twentieth centuries.[1]

There are various social and political reasons for this growth, including the withdrawal of governments from areas which traditionally were dominated by them, especially in Europe; increasing complexity and polyarchy in today's society and an awareness of the importance of supranational purposes, such as environmental purposes and developing purposes backed up by the recent expansion of Internet technology. In addition, philanthropic organizations in many areas have become professional pools of specialized knowledge to which governments are willing to grant financial resources in order to fulfil "public policy" tasks. Like corporations, philanthropic organizations may easily create and improve ties with people and organizations in other nations and therefore are designated as being at the vanguard of international developments.

Despite their growing importance, philanthropic organizations have long been the lost continent on the world's social landscape and did not attract serious attention in

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[1]. Lester M. Salamon, S. Wojciech Sokolowski and Regina List, *Global Civil Society*, (Baltimore: the Johns Hopkins Center for Civil Society Studies, 2003).

policy circles or academic interest.[2] It is only recently that philanthropic organizations, social investment and related topics have become very catchy in a time where dissatisfaction has grown with both the market and the state as mechanisms to resolve the interrelated social, economic and environmental crises of this era. The state stands accused of stifling initiative, creating unresponsive bureaucracies, and generally absorbing escalating shares of national income. The market, on the other hand, has been criticized for ignoring human need and producing untenable social inequalities. The result has been an increasingly frantic search for a middle way between sole reliance on the market or the state to cope with public problems – a search that is evident in former Prime Minister Tony Blair's emphasis on a Third Way in the United Kingdom, Gerhard Schröders's New Middle in Germany and former French Prime Minister Lionel Jospin's summary declaration, "Yes to a market economy, no to a market society".[3]

At a more practical level, philanthropic organizations are increasingly influenced by commercial considerations as a result of the overall rationalization of society. Also inspired by the process of ongoing reductions in government spending, the philanthropic sector is facing the need to commercialize and move towards cooperation with the corporate sector, which in turn can use the do-gooder image of the philanthropic sector to balance the damage to their reputation due to affairs such as Enron, Worldcom and Ahold.

Also, creativity will be required to attract new resources from the private sector; the area of planned giving, developed in the United States, shall for this purpose hesitatingly be followed in other countries. On the other side, individual citizens have become more conscious of public interests overreaching their own restricted geographical area, and are considering financial support of philanthropic organizations more as "investments", rather than simple cash gifts, and are behaving accordingly. This requires philanthropic organizations to create more transparency towards their stakeholders. The twenty-first century will be the platform of the maturation of internationalization in this sector. The existing sources of international

[2]. Id. at 3.

[3]. Id. at 2.

tax law contain only sparse words not only with regard to non-profit entities, but also on flows of money between those entities and third persons.

Some statistical data are available on the growth of international giving in the United States. The US Foundation Center, in cooperation with the Council on Foundations, has examined the role of private grantmakers (US private foundations and community foundations) in cross-border funding and US-based international philanthropic programmes; from a legal perspective the funding for US-based international programmes is not considered to be cross-border giving, as these programmes are operated actively by US philanthropic organizations. It reported a growth of estimated international giving from 51% between 1994 and 1998, reaching an estimated $ 1.6 billion in 1998. From 1998 to 2002, international giving climbed 76% effectively to $ 3.2 billion, far exceeding the 41% gain in overall giving. The most recent report announced a record of $ 3.8 billion in 2005; adjusted for inflation, international giving climbed nearly 12% relative to 2002, far surpassing the 2% in overall giving.[4]

It is in these circumstances where the traditional three-sector division between government, the for-profit sector and the non-profit sector is becoming blurred and internationalization is taking place, that many developed countries are in the process of modernizing their laws regulating philanthropic organizations. That process imposes challenges to both common law and civil law traditions. In a recent report "International Comparisons of Charitable Giving" by the UK-based Charities Aid Foundation, it is stressed that "charitable giving increasingly needs to be understood in an international context. With populations migrating and the growth in public awareness of international issues and needs, more people globally are interested in making cross-border charitable donations to charity".[5]

The subject of this study will focus on a part of the non-profit sector which can best be defined as "philanthropy". Philanthropy may be defined as voluntary and private

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[4]. Lorenz Renz and Josefina Atienza, "International Grantmaking Update" (October 2003 and 2006), downloadable from http://foundationcenter.org/media/news/pr_0411a.html.

[5]. CAF briefing paper, "International comparisons of charitable giving" (November 2006), downloadable from www.efc.be/ftp/public/cpi/Newsletter_Jan07/InternationalGivinghighlights.pdf.

initiative to support a public objective. A philanthropic organization is bound by public values, thereby exceeding the level of mere restricted or self-interest. The motive of the private initiator is irrelevant for the qualification of philanthropy. Philanthropy may both take the form of a gift by a wealthy individual or the sponsorship by a for-profit company, as long as predominantly the public cause is served.[6]

In Chapter 2, the definition and essential features of philanthropic organizations will be examined.

1.2. International tax barriers: the landlock

The development of the functioning of philanthropic organizations ideally should not be hampered by international tax barriers. The tax position of philanthropic organizations is based exclusively on national legislation and, as a rule, involves a preferential treatment with regard to corporate income tax and donation (gift) and inheritance (estate) tax, and offers tax deductibility in many situations for both individual and corporate benefactors. However, it seems not at the least a matter of course that this tax relief is equally applicable in an international context. It is striking that at the present time, the development of philanthropic organizations across borders is hampered to such extent by restrictions in tax regimes which can be summarized under the label of a landlock.

1.2.1. Denomination of the landlock

Landlocked elements of a tax regime are characterized by any direct or indirect geographical limitation imposed as a condition for privileged tax treatment of philanthropic activities. Philanthropic organizations may find themselves in a landlocked position if they are facing restrictions under the tax rules of their home country which limit or place demands on the organization in its efforts to expand its

[6]. Th.N.M. Schuyt, *Filantropische studies: Capita Selecta*, (Utrecht: Uitgeverij de Graaff, 2002), at 16.

philanthropic activities partly or integrally to other countries. Also, a philanthropic organization may encounter a landlocked tax regime in a foreign country where it seeks to pursue its objects of bounty, for example by incurring a huge foreign gift tax liability resulting from gifts contributed by foreign resident individuals or corporations. In a hypothetical worst-case scenario, there may not be any tax incentive at all because of the various landlocked elements in the various tax regimes.

The benefactors wishing to support a foreign philanthropic organization may run afoul of a landlocked income tax incentive that is available only for domestic philanthropy. A benefactor may also face a (secondary) gift tax liability for gifts to foreign philanthropic organizations; although the recipient normally is liable for any gift tax due, it is easier for tax authorities to collect the gift tax from a secondarily liable person that is resident in the country in which those authorities have jurisdiction. It is not infrequent that further restrictions apply, in that, for example, the domestic organization may not (or may only under qualifying circumstances) use the funds for foreign objectives. Even where a foreign benefactor wishes to support a domestic philanthropic organization through the donation of domestic-situs real property, in many countries no privileged taxation will apply.

From the perspective of a donor and indirectly, from the perspective of a foreign philanthropic organization trying to raise funds across borders, a landlock is manifest where a gift to a foreign philanthropic organization benefits from a decreased level of income tax relief vis-à-vis a similar gift to a similar domestic philanthropic organization. Many jurisdictions have a manifest landlock regarding the philanthropic donation of domestic-situs assets donated by a non-resident person, or alternatively to a non-resident philanthropic organization, or both. From the perspective of the donor and the philanthropic organization, a landlock exists where a gift or a bequest to a philanthropic organization in another country is subject to higher gift or estate tax as compared to a similar gift to a domestic philanthropic organization.

From the perspective of a philanthropic organization, the notion of a landlock is directly present where international spending or grantmaking entails more onerous and disproportionate rules as compared to domestic grantmaking. As far as (corporate) income taxes are concerned, a landlock may often be found between domestic and foreign philanthropic organizations with regard to similar types of income. When reviewing various legal systems, one may find many other landlocked provisions which are woven into the specific design of that legal system. It is therefore not possible to describe on a limitative basis all aspects of a landlocked provision.

From the perspective of national tax systems, a distinction can be made between inbound and outbound elements of a landlock. Inbound elements of a landlock refer to impediments for foreign philanthropic organizations carrying on activities in the host country, such as ownership of real estate or carrying on entrepreneurial activities. Outbound manifestations of a landlock refer to gifts, bequests or other activities for foreign philanthropic purposes that do not qualify for the same privileged treatment as domestic gifts or bequests to similar organizations. As this distinction does not add any value nor gives any concrete insight into the merits for philanthropy, this study will not elaborate on this distinction.

Where today international philanthropy is the area in international tax in which discrimination remains a common feature, the environment for cross-border philanthropy lags behind in this rapidly changing and increasingly internationalized society in which citizens move and trade, and investment has gone global. Tax-effective philanthropy still begins and ends at home.[7]

Upon the initiative of the King Baudouin foundation established in Belgium, a website has been developed that gives practical insight into some of the most salient manifestations of the landlock in a European context: givingineurope.org contains details regarding basic legal and tax applications of 25 countries of the European Union, including the new EU Member States (except for Bulgaria and Romania) and Switzerland. This website makes it possible to review situations in which the donor, donee and situs of assets are in three different EU countries, and the results are often disappointing.

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[7]. Executive Summary of the EFC Tax Seminar 2004, "How to improve cross-border giving in Europe; barriers and solutions – foundations' perspective", European Foundation Centre, www.efc.be/ftp/public/eu/Tax/Report_TaxSeminar2004.pdf.