CROSS-BORDER CHARITABLE GIVING:

International Philanthropy
and Tax Laws

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JANE PEEBLES, ESQ.
Karlin & Peebles, LLP
8383 Wilshire Blvd., Suite 708
Beverly Hills, California 90211
(310) 274-5245
jpeebles@karlinpeebles.com

Jane Peebles is a senior partner in Karlin & Peebles, LLP in Beverly Hills, California. She is certified by the California State Bar Association as a specialist in Estate Planning, Probate and Trust Law. Jane is also a nationally recognized lecturer and author on a variety of domestic and international estate and charitable planning matters. Ranked one of the Top 50 Female Super Lawyers in Southern California in 2005 through 2007, and a Southern California Super Lawyer and Best Lawyer in America in the specialty of Trusts and Estates each year since 2008, Jane has dedicated her practice to U.S. and international estate and charitable planning. She is a Fellow of the American College of Trust and Estate Counsel.

Jane Peebles
Principal
Karlin & Peebles, LLP
8383 Wilshire Blvd., Ste. 708
Beverly Hills, CA 90211
(310) 274-5245

jpeebles@karlinpeebles.com

www.karlinpeebles.com

TABLE OF CONTENTS

TABLE OF CONTENTS
(continued)

Page

TABLE OF CONTENTS
(continued)

Page

CROSS-BORDER PHILANTHROPY

1. INTRODUCTION

While many are content to focus their philanthropy near home, increasing numbers wish to aid causes abroad. Whether the motivation be compassion, personal ties to a foreign country, political expediency or moral conviction, there is no question that international charitable giving is on the rise as the economy becomes increasingly globalized.

Donations abroad by Americans, whether direct or indirect, have been steadily growing in spite of U.S. isolationist policies dating back to 1938, when Congress first denied U.S. donors charitable deductions for gifts made directly to foreign charities. Donations to U.S. charities by foreign donors have also increased dramatically in recent years.

Over the years, Americans have developed, and the Internal Revenue Service[1] has sanctioned, various methods of making indirect deductible overseas charitable gifts. The rules governing these methods are highly complex and are the topic of the bulk of this outline. The outline explains the basic tax rules applicable to cross-border charitable gifts by U.S. citizens and residents, gifts by nonresident aliens to U.S. charities, and special treaty provisions affecting both. It also reviews the basics of U.S. income and transfer taxation of nonresident aliens and noncitizens as a rudimentary understanding of these topics is vital to optimal structuring of their charitable gift vehicles.

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1 Subsequently referred to as the "IRS."

2. GENERAL OVERVIEW OF RULES APPLICABLE TO GIFTS BY U.S. PERSONS TO FOREIGN CHARITIES

2.1 INCOME TAX DEDUCTION

2.1.1 As a general rule, contributions by any individual directly to a foreign entity or organization do not qualify as charitable contributions under section 170(c) of the Internal Revenue Code[2] and may not be deducted for U.S. income tax purposes. Contributions to a foreign government, corporation, trust, community chest, fund or foundation are within the scope of this rule. Certain treaty exceptions exist and are discussed in Section 9 below. The rule that tax exempt organizations gifts to which are deductible must be created or organized in or under the laws of the United States, any State, the District of Columbia or any U.S. possession is found in IRC section 170(c)(2)(A).[3]

2.1.2 Congress has expressed its justification for allowing a deduction for contributions to U.S. charities, and denying a deduction for direct contributions to foreign charities, as follows:

> [When a contribution is made to a U.S. charity, the] government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare. The United States derives no such benefit from gifts to foreign institutions.[4]

2.1.3 Under the general rule of IRC section 170(c), the IRS and the courts have denied income tax deductions for transfers to a private orphanage in Equador[5]; the State of Israel[6]; Catholic churches in France[7]; the University College of

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[2] Internal Revenue Code of 1986, as amended. Subsequently referred to as the "Code" or "IRC."

[3] IRC §170(c) organizations are referred to in this outline interchangeably as "U.S. charities," "U.S. nonprofit organizations" and "U.S. tax exempt organizations."

[4] H. Rep't. No. 1860, 75th Cong., 3d sess., pp. 19-20, 1939-1 C.B. (Part 2) 728, at 742.

[5] Tobjy, T.C.M. 1986-62.

[6] Hess, T.C.M. 1971-242.

[7] Herter, T.C.M. 1961-19.

Mandalay, Burma, and other Burmese charitable organizations[8]; and First Church of Christ Scientist, Berne, a corporation organized under Swiss law.[9]

2.1.4 A contribution made directly to a bi-national charitable foundation organized under the laws of both the United States and a foreign country is not entitled to a U.S. income tax deduction since the donee is not organized exclusively under U.S. law.[10] Bi-national charitable foundations are created by executive agreement between the United States and a foreign country and financed by property contributed equally by the two countries. Their assets, including the contributed property, must be equally divided between the United States and the foreign country in the event of a dissolution of the foundation.

2.1.5 As long as the donee organization was created and organized under the laws of the United States, use of all or a portion of its funds in a foreign jurisdiction does not preclude deductibility.[11] The rules governing the deductibility of gifts to U.S. charities which use funds abroad are highly complex and are discussed in detail below. There are also certain treaty exceptions, described below.

2.2 GIFT TAX DEDUCTION

Subject to limited exceptions discussed in Section 4.1 below, gifts to foreign charitable organizations are deductible for U.S. gift tax purposes under IRC section 2522(a).

2.3 ESTATE TAX DEDUCTION

Bequests to foreign charitable organizations are also generally deductible for U.S. estate tax purposes under IRC section 2055(a).

3. SPECIAL INCOME TAX CONSIDERATIONS

3.1 RESTRICTIONS ON DONATIONS FOR FOREIGN USE

In the absence of a treaty exception, a direct donation to a charity created or organized abroad is not deductible even if the donee has an IRS determination letter. Under IRC section 170(c), a charitable contribution must be made to an eligible domestic charitable organization. For this purpose, however, the IRS focuses on the

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8 ErSelcuk, 30 T.C. 962 (1958).

9 Welti, 1 T.C. 905 (1943).

10 Rev. Rul. 76-195, 1976-1 C.B. 61.

11 Treas. Regs. §1.170A-8(a)(i); Rev. Rul. 63-252, 1963-2 C.B. 101; GCM 37444 (3/7/78).

country in which the donee organization was created rather than on the country where the funds are used. Therefore, a donee U.S. organization may carry on part or even all of its charitable activities outside of the United States without jeopardizing the deductibility of contributions it uses for such purposes.[12]

3.2 U.S. CHARITIES WITH DIRECT FOREIGN OPERATIONS

The simplest way to channel a deductible contribution abroad is to make it to a U.S. charity which operates abroad through a foreign branch office or subsidiary. The contribution is considered to be for use abroad by the U.S. charity. Since the foreign subsidiary is under the complete control of the U.S. charity and serves merely as its administrative arm, the U.S. charity is considered the true beneficiary.

> Example: Z is a U.S. charitable corporation. A portion of Z's activities consists of operating a Montessori school in Paris. To facilitate its French operations, Z forms a subsidiary in France, which is subject to total administrative control by Z. Z solicits funds from U.S. donors for the specific purpose of carrying out the charitable activities of the French subsidiary. Contributions to Z are deductible because the French subsidiary is only an administrative arm of Z, which is the true beneficiary. Donations are to be used by Z in a foreign country, rather than to be used by a foreign organization.[13]

3.2.1 If a U.S. charity operates abroad through a foreign branch office or subsidiary, all of the problems of making a grant or donation to a non-U.S. entity are avoided. The donor need satisfy no further requirements than if the ultimate recipient were a local charity.

3.2.2 A number of "international" U.S. charities have broad-based direct programs abroad. Examples include the Red Cross, CARE and Oxfam America. It is permissible for a donor to earmark contributions for a particular program of such a U.S. charity (such as its work in South America or its disaster relief effort in Africa) as long as the earmarking is limited to programs subject to total control by the grantee. *This is the only situation in which earmarking for use abroad is permitted.*

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12 Rev. Rul. 71-460, 1971-2 C.B. 231. See also Rev. Rul. 80-286, 1980-2 C.B. 179, Rev. Rul. 68-165, 1968-1 C.B. 253, Rev. Rul. 68-117, 1968-1 C.B. 251.

13 Rev. Rul. 63-252, 1963-2 C.B. 101, Ex. 5; Bilingual Montessori School of Paris, Inc., 75 T.C. 480 (1981).

3.3 U.S. "FRIENDS OF" OR "FEEDER" ORGANIZATIONS

A U.S. public charity may be formed exclusively to support a foreign charity or charities. However, contributions to an approved U.S. intermediary must be made for exclusively charitable purposes and must not be "earmarked" for distribution to a nonqualified foreign grantee organization. "Friends of" organizations have often been organized as Type III supporting organizations. Many are now organized as private foundations or as public charities under IRC section 509(a)(1).

3.3.1 The IRS has ruled that gifts to a U.S. organization which serves as a conduit, merely funneling earmarked donations to non-U.S. charities, are not deductible for U.S. income tax purposes. Revenue Ruling 63-252[14] addresses the deductibility of contributions by individuals to a U.S. charity which then transmits some or all of its funds to a foreign charity. In Example 4 of the ruling, a U.S. charitable organization made grants to a foreign charity for purposes which the U.S. organization reviewed and approved as being in furtherance of its own charitable purposes. Donations to the U.S. charity were not earmarked in any way for the foreign charity, and their use was subject to control by the U.S. charity. The IRS ruled that the donations were deductible because the U.S. charity exercised sufficient control over the funds to be considered the recipient of the gifts within the meaning of IRC section 170(c)(2).

3.3.2 The IRS has enumerated several procedures to be followed by U.S. public charities which make grants to foreign charities. These procedures are intended to ensure that the U.S. charity retains appropriate discretion and control over the use of such grants to ensure that the funds are used solely for charitable purposes.[15]

3.3.3 U.S. corporate donors and grant making foundations making grants to U.S. intermediary "friends of" organizations should independently review grant applications and bylaws of the donees to be sure the "feeder" organizations meet the following requirements:

a. The board of directors of the U.S. charity should review the purposes of the donee foreign charity and determine that they are analogous to those of U.S. nonprofits, i.e., that they conform to IRC section 170(c)(2).

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[14] 1963-2 C.B. 101; Ex. 4, amplified by Rev. Rul. 66-79, 1966-1 C.B. 48.

[15] A number of these procedures are set forth in private rulings. See, e.g., the following, all of which concluded donations were deductible: PLR 8408062 (funds contributed by U.S. charity to foreign project for preservation and restoration activities), PLR 8346038 (contributions to U.S. charity which makes donations to foreign monastery, where board approval precedes donations), PLR 8124124 (U.S. charity which makes grants to foreign theological seminaries, where U.S. charity's bylaws assure control over funds). See also PLR 8043026, PLR 8034139, PLR 7943102, GCM 37444 (3/7/78).

b. The board should also review and approve specific projects and related solicitation programs.

c. The U.S. charity should enter into an agreement with the foreign donee organization regarding the use of the donated funds. Projects for which funds are to be expended should be specified in detail in the agreement.

d. The U.S. charity should require accountings or sufficiently detailed line item financial reports from the foreign charity to enable the U.S. charity to account for use of the donated funds.

e. The U.S. charity should retain the exclusive power to refuse any conditional or earmarked donations to it. Furthermore, the U.S. charity should not legally obligate itself in any way to expend contributed funds for the use of foreign charities or projects, but may indicate its intention to expend the funds for such purposes to the extent consistent with its own charitable purposes. While the U.S. charity may solicit funds for specific projects abroad, it must retain discretion to use the funds for other exempt purposes which it determines to be more appropriate. In support of this discretion:

(1) The U.S. and supported non-U.S. charities should not have identical or substantially overlapping boards.

(2) The U.S. charity should serve some independent purpose other than merely remitting funds to the non-U.S. charity.

(3) The U.S. charity should use some portion of its funds in the United States or for purposes that may be of mutual benefit to the U.S. charity and the foreign charity.

(4) The U.S. charity's fundraising materials should clearly advise potential contributors that all donated funds are subject to the independent control of the U.S. organization.

3.4 **CORPORATE CONTRIBUTIONS**

A further special restriction applies to corporate contributions. Under IRC section 170(c), corporate contributions intended for use outside of the United States are not deductible unless the donee is a U.S. *corporation*.[16] For this reason, U.S. charities with international operations are generally organized as corporations rather than as trusts or unincorporated associations.

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[16] IRC §170(c) provides: "A grant or gift by a corporation to a trust, chest, fund or foundation shall be deductible ... only if it is used within the United States or any of its possessions ...."

3.4.1 A U.S. corporation may make deductible donations to a U.S. IRC section 501(c)(3) charity with direct operations through a foreign branch or subsidiary as long as the U.S. charity is a corporation.

3.4.2 A U.S. corporation may deduct contributions to a private foundation that makes grants to foreign charities, whether or not the private foundation is organized and controlled by the U.S. corporate donor, as long as there is no "earmarking" of the grant and as long as the donee foundation is organized in corporate form.

3.4.3 Donations abroad by a U.S. corporation through a U.S. public charity "friends of" organization are also deductible as long as the donee "feeder" is a corporation.

3.5 GRANTS BY U.S. PUBLIC CHARITIES FOR USE ABROAD

Both U.S. public charities and U.S. private foundations that make grants to non-U.S. organizations are well-advised to include in their bylaws, as applicable to all grants to foreign charities, the various procedures and restrictions listed above with respect to donations to "friends of" organizations. Public charities making grants abroad are subject to fewer legal requirements than are private foundations. However, even the board of a public charity has a fiduciary duty under its governing instruments to ensure that the funds under its control are used solely for charitable purposes. If the U.S. charity cannot give adequate proof that it operates exclusively for charitable purposes, the IRS can revoke its tax-exempt status. In order to be in a position to provide such proof, the U.S. charity must exercise sufficient discretion and control over the use of the funds.

3.5.1 The IRS has provided guidance as to what constitutes sufficient "discretion and control" by U.S. "friends of" organizations and private foundations, but it has not yet provided specific guidance as to the degree of documentation and oversight by a public charity needed to qualify under this requirement. Any public charity wishing to make grants abroad should look to the rules governing grants by "friends of" organizations and the stricter rules governing grants abroad by private foundations as the "safe" route. It should consult with legal counsel to set up forms, procedures and recordkeeping systems that will protect it from IRS challenges.

3.5.2 The Council on Foundations recommends that U.S. public charities adopt a three-step procedure for foreign grants.[17] These steps consist of (i) obtaining documentation from the grantee, (ii) entering into a written agreement with the grantee which documents the grantee's commitments and (iii) obtaining annual accountings from the grantee each year until the grant funds have been fully expended.

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17 See Edie, John A. and Nobler, Jane, Beyond Our Borders: A Guide to Making Grants Outside the U.S., Council on Foundations, Washington, D.C. (4th Ed., 2011).

a. The U.S. public charity is not required to make a determination that the foreign grantee organization is the equivalent of an IRC section 501(c)(3) organization, but it will be in a stronger position on audit if its files contain solid information regarding the grantee. The Council on Foundations therefore recommends that the U.S. charity obtain copies of all of the foreign charity's organizational documents and a description of all of the activities and programs of the grantee, including proposed activities. These documents should be translated into English.

b. A written agreement between the U.S. grantor and the foreign grantee should commit the grantee to use the funds for strictly charitable purposes, and the purposes of the grant should be specified. Grants by a U.S. public charity for the general support of a foreign charity are allowed. However, it is unsafe to make a grant for the general support of a foreign charity unless the grantee is clearly the equivalent of an IRC section 501(c)(3) organization operated exclusively for charitable purposes and either (i) the foreign charity is a well-established organization equivalent to a U.S. public charity or (ii) the U.S. grantor charity has had a long trouble-free relationship with the foreign grantee charity. The written agreement should also commit the grantee to the basic requirements of section 501(c)(3) prohibiting private inurement, attempting to influence legislation, affecting the outcome of elections, and distributing assets to one or more other charities in the event of termination.

c. The foreign charity should be required to provide the U.S. public charity with a written financial report at the end of each of its accounting periods until the grant has been fully expended. These reports will help demonstrate that the U.S. charity has taken appropriate steps to allow it to exercise the necessary discretion and control over the use of the funds. Such reports should describe the use of the funds, the donee's compliance with the terms of the grant and the progress it has made in achieving the purpose of the grant.

3.5.3 The procedures delineated above should be adopted by all U.S. public charities making grants abroad, including community foundations making grants from unrestricted funds. Community foundations, by their very nature, generally have geographic restrictions in their governing documents, so any proposed expansion beyond those boundaries will have to be carefully considered by the board and specifically authorized by the governing documents (with such authorization effective only prospectively). Moreover, if the grant abroad will not come from unrestricted funds, other issues may arise.

a. If the donor to a "field of interest" fund has specified a particular charitable focus, but has left total discretion to the community foundation to determine the ultimate grantee, the community foundation may make grants to a foreign charity from the fund without any additional problems.

b. Donors to "donor advised funds" are able to make only nonbinding recommendations as to the use of the funds, so grants to foreign charities from donor advised funds do not by themselves cause problems. However, if the community foundation permits grants abroad from donor advised funds but not from unrestricted funds, the IRS may argue that the "advised fund" is in fact subject to donor control and therefore deny any income tax charitable deduction for the donor's gifts. Also, since a U.S. donor would not be entitled to a deduction for a direct contribution to a foreign charity, a U.S. donor advisor should not be able to navigate around this limitation by utilizing an advised fund. Note that donor advised funds offered by for-profit organizations cannot, under applicable law, make grants abroad.

c. Under limited circumstances, a U.S. donor may wish to give funds to a U.S. intermediary subject to the donor's designating the ultimate recipient. While a donor can obtain a deduction for a donation to a U.S. "friends of" organization and know that the funds will likely be funneled to a specific foreign charity, a donation designated for a specific foreign charity is risky since the intermediary charity must exercise independent discretion and control over the use of the funds.

3.6 GRANTS BY PRIVATE FOUNDATIONS FOR USE ABROAD

Private foundations are subject to stringent requirements regarding the manner in which they may make grants abroad. Failure to adhere to these requirements may cause the U.S. private foundation and its managers to be subject to penalties imposed under IRC sections 4942 (regarding qualifying distributions) and 4945 (prohibiting lobbying and related activities).

3.6.1 IRC section 4942 requires a U.S. private foundation to make "qualifying distributions" of a certain minimum amount each year. "Qualifying distributions" generally consist only of amounts paid to accomplish religious, charitable, scientific, literary or other purposes described in IRC section 170(c)(2)(B). A grant by a U.S. private foundation to a foreign organization which has applied for and received an IRS determination letter that it is a public charity,[18] a supporting organization,[19] or a private operating foundation,[20] is always a "qualifying distribution" for purposes of the

[18] Public charities under IRC §509(a)(1) include certain churches, hospitals, schools and other publicly supported organizations described in IRC §170(b)(1)(A) and organizations that receive a significant amount (usually at least one-third) of their revenue from contributions from the general public.

[19] An IRC §509(a)(3) public charity is an organization formed to support one or more 509(a)(1) or 509(a)(2) organizations. A so-called "supporting organization" may fund the supported charity's activities or itself carry on activities that serve the support charity's purposes. It will in all events qualify under §509(a)(3) if the supported organization controls it, such as by appointing a majority of its board, and if certain other technical requirements are met.

[20] A private operating foundation under IRC §509(a)(2) makes qualifying distributions directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated, and is treated as a public charity. Examples include the operation of museums, public parks and historic sites.

5% minimum distribution rule. A grant by a U.S. private foundation to a foreign charity which has *not* received such an IRS determination letter is not considered a "qualifying distribution" unless the distributing foundation has made a "good faith determination" that the foreign donee meets the qualifications of such an organization, or exercises expenditure responsibility over the grant. Since few foreign charities go to the trouble of obtaining IRS determination letters, this "good faith determination" or, if such determination cannot be made, then the exercise of expenditure responsibility, will almost always be required.

The Council on Foundations secured a general information letter from the IRS, issued April 18, 2001, which may be relied on by all U.S. grant making private foundations, confirming that **private foundations need not attempt a good faith equivalency determination before turning to expenditure responsibility.** This clarifies that (i) a private foundation may jump directly to expenditure responsibility if it concludes, based on preliminary information regarding the proposed grantee, that it clearly will be unable to make a good faith equivalency determination, or if (ii) it is clear that the foundation will not be able to collect from the proposed grantee the data needed to attempt a good faith equivalency determination.

3.6.2 IRC section 4945 is designed to prohibit (i) foundation involvement in legislative activities and politics, (ii) certain grants to individuals without prior IRS approval of grant procedures, (iii) grants to organizations other than public charities unless the grantor exercises "expenditure responsibility" and (iv) grants for noncharitable purposes.

3.6.3 U.S. private nonoperating foundations are required to make annual "qualifying distributions" to other charities equal to 5% of the value of the grantor private foundation's net assets held for investment. If a U.S. private foundation wishes to make a grant to a foreign charity which does not have an IRS determination letter, it must either (i) determine that the foreign charity is the equivalent of a U.S. public charity or (ii) exercise "expenditure responsibility." If the U.S. grantor foundation has made a good faith determination that the foreign grantee is the equivalent of a U.S. public charity, the grant will qualify to count toward the minimum payout requirement even if the U.S. charity does not exercise "expenditure responsibility."

a. In determining whether and how to make a grant abroad, a U.S. private foundation should first determine that the grant is for a charitable purpose.

b. Next, it should gather the necessary documentation to allow it to determine whether the proposed grantee is the equivalent of a U.S. IRC section 501(c)(3) organization. If the grantee is the equivalent of a U.S. public charity, the review process is complete. If the equivalency determination fails, or if the foreign charity is the equivalent of a U.S. IRC section 501(c)(3) organization but is also the equivalent of a U.S. private foundation, then the grantor must exercise expenditure responsibility.

3.6.4 The IRS will ordinarily consider the U.S. grantor foundation to have made a "good faith determination" that the foreign donee is the equivalent of a U.S. public charity if the determination is based on an affidavit of the grantee or an opinion of counsel of the grantor or the grantee that the grantee is a public charity.[21] The affidavit or opinion must set forth sufficient facts concerning the grantee's support and operations to allow the IRS to determine independently that the grantee would likely qualify as a U.S. public charity.[22] This means that, although the foreign grantee does not have to go through the process of obtaining an IRS determination letter, it must provide to the grantor private foundation substantially all of the same data the IRS would have required to make a determination.

a. An example of a satisfactory affidavit of a grantee organization has been provided by the IRS in Revenue Procedure 92-94,[23] reproduced as Appendix A. Many private foundations will choose to use the precise form of affidavit approved by the IRS.

b. In any event, the grantor foundation's file should, at a minimum, contain the following, all translated into English as necessary:

(1) Copies of the grantee's organizational documents (i.e., articles of incorporation, charter, memorandum of association, certificate of incorporation or equivalent) and, preferably, its bylaws as well.

(2) A detailed description of the grantee's purposes and all of its past, current and proposed activities.

(3) A copy of the relevant statutory law or provisions in the grantee's governing instrument dictating how the grantee's assets are to be distributed if it ceases operations.

(4) Demonstration by the grantee that (i) its assets and income may not provide any private benefit to any individual, (ii) noncharitable activities and lobbying are and will continue to be insubstantial, and (iii) it will not directly or indirectly participate or intervene in any public election or political campaign. Each of these requirements may be satisfied by providing copies of relevant statutes by which the grantee is bound or copies of its own governing instruments.

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21 Treas. Regs. §53.4945-5(a)(5).

22 Id.

23 Rev. Proc. 92-94, 1992-2 C.B. 507.

(5) If the grantee is not a religious institution or medical or educational organization, detailed financial data for several years is required.

c. The grantor may also wish to obtain an opinion from its legal counsel on which it may rely in making a grant to a foreign charity. This protects the managers of the foundation from being personally subjected to penalty taxes since they will be deemed to have acted with "reasonable cause" if they approve a grant to a foreign grantee based upon a written opinion of counsel.[24]

NOTE: The Department of Treasury issued proposed regulations under IRC Section 4945 on September 24, 2012 applicable to private foundations seeking to make grants to foreign organizations using equivalency determinations. The guidance broadens the range of professionals on whose written advice a private foundation may rely when making such grants. Previously, reliance on the written opinion of counsel of the private foundation or grantee was permitted. The proposed regulations expand that class of professionals to attorneys, certified public accountants, or enrolled agents who are subject to certain professional conduct rules of the IRS, thereby removing one key obstacle to the creation of an equivalency determination repository. The regulations were issued in proposed form but private foundations may begin to rely upon them immediately. While the regulations are not explicitly applicable to public charities engaged in international grantmaking, the guidance should pave the way for public charities as well.

3.6.5 The form of written foreign grantee affidavit approved by the IRS in Revenue Procedure 92-94 has a major advantage over procedures previously available. If the process of making a reasonable determination that the foreign charity is the equivalent of a U.S. public charity is based on a lawyer equivalency letter of the type described in Treasury Regulation section 53.4945-5(a)(5), each potential U.S. grantor private foundation must obtain its own letter. However, more than one foundation may rely on a Revenue Procedure 92-94 form of affidavit. This substantially simplifies and lowers the cost of the procedure, making it accessible to small and medium sized foundations.

a. Any such affidavit must be "currently qualified." An affidavit is currently qualified if it reflects the grantee's current accounting year or is updated for current data.

(1) If the grantee's status does *not* depend on public financial support, the update need only describe any facts that have changed or state that there have been no changes.

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[24] See IRC §4945(a)(2); Treas. Regs. §53.4945-1(a)(2)(vi).

(2) If the grantee's status *does* depend on financial support, the update must include an attested statement containing enough financial data to establish that it continues to meet the statutory requirements. Since meeting the public support test in one year generally preserves public charity status for the next two years, this data will not necessarily be from the grantee's latest accounting year.

b. The affidavit must be in English (although the financial data need not be in U.S. dollars), and all supporting documents must be translated into English. Copies of the grantee's governing documents must be attached.

c. The affidavit must state:

(1) The grantee's purpose;

(2) The nature of the grantee and its past, current and anticipated future activities; and

(3) Specific assertions as to the grantee's meeting various requirements of a U.S. public charity, including the source of the necessary prohibition against private inurement (local law or custom or the governing documents), a dissolution clause assuring that the grantee's assets must pass to another charitable organization should it cease operations, and statements that local laws or customs or the grantee's governing instruments prohibit lobbying except to an insubstantial extent and prohibit direct or indirect intervention in any political campaign.

d. Any educational institution must state that it operates pursuant to a racially nondiscriminatory admissions policy as to students.

e. A principal officer of the foreign charity must attest to the truth of the affidavit.

3.6.6 "Expenditure responsibility" will be required if the foreign charity:

a. Can qualify as the equivalent of a U.S. IRC section 501(c)(3) organization but cannot qualify as a public charity and is therefore deemed to be a private foundation. This may occur if it cannot provide sufficient data on public support or if it is largely dependent on a single private source of funds. If the grantee is a private foundation, the "out of corpus" rules discussed at Section 3.6.9 below must also be satisfied;

b. Simply cannot provide sufficient documentation to support a reasonable judgment of public charity equivalency even though it appears to be a legitimate charity;

c. Is not organized and operated exclusively for charitable purposes (i.e., because it is a chamber of commerce, trade or professional association or labor union);

d. Operates in part to affect political campaigns or in substantial amount to lobby; or

e. Is a for-profit business.

Under these circumstances, the U.S. private foundation grantor will be subject to penalties if it does not exercise "expenditure responsibility."

3.6.7 Expenditure responsibility entails the following steps:

a. A pre-grant inquiry to allow the private foundation to make a reasonable determination that the proposed grantee is able to fulfill the charitable purpose of the grant.

b. A written grant agreement signed by an officer or director of the grantee which specifies the charitable purposes of the grant and commits the grantee to (i) repay any funds not used for the grant's purpose, (ii) submit annual reports, (iii) maintain books and records which are made reasonably available to the grantor, and (iv) refrain from using any of the funds for lobbying, direct or indirect influence on any public election or voter registration drive, or any activity for a noncharitable purpose, to the extent such use of the funds would be taxable to a private foundation. The agreement will typically also prohibit the grantee from re-granting the funds to other organizations or individuals since that triggers additional complicated rules meant to minimize the risk of diversion of funds.[25]

c. Grantee reports on the status of the grant, including a description of how the funds have been used, compliance with the terms of the grant agreement and the grantee's progress in achieving the purposes for which the grant was made. These should be submitted annually, starting at the end of the grantee's accounting period in which the grant was made and for each accounting period until the grant has been fully expended.

d. Notice to the IRS that an expenditure responsibility grant has been made. This is normally provided as an answer to a standard Form 990-PF tax return inquiry as to whether any such grants have been made.

e. If the grantee is *not* the equivalent of a private foundation, it must maintain all grant monies in a separate fund dedicated to one or more charitable

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[25] IRC §§4945(d)(3), 4945(d)(4), 4945(g) and 4945(h).

purposes described in IRC section 170(c)(2)(B).[26] No additional reporting requirements are imposed regarding this separate fund other than those described in steps c and d above.

f. There are additional rules governing situations such as what the grantor foundation must do if the grant funds are diverted from charitable purposes.

3.6.8 Grants to foreign governmental units do not require either an equivalency determination or expenditure responsibility. The regulations provide that a foreign organization will be treated as a public charity if it is a "foreign government, or any agency or instrumentality thereof ... even if it is not described in IRC section 501(c)(3)."[27] However, any grant to such a governmental unit must be for charitable, not public, purposes.[28]

3.6.9 If the foreign charity grantee is the equivalent of a U.S. private foundation, the U.S. foundation's grant to it must also meet the "out of corpus" requirement. A grant from one private foundation to another will not meet the definition of a qualifying distribution for purposes of application of the 5% minimum payout rules to the *grantor* unless the *grantee* satisfies the "out of corpus" rule. Treasury Regulation Section 53.4942(a)-3(c) specifies that "corpus" in this context refers to a private foundation's endowment or fund balance.

a. The "out of corpus" rule requires that any grant from one private foundation to another must be spent by the grantee within 12 months after the close of the taxable year in which it received the funds. One private foundation cannot make grants to endow another. The grantee must take the grant funds "out of corpus" and spend them within the required amount of time. This requirement should be included in the grant agreement between the grantor U.S. charity and the grantee foreign charity.

b. Furthermore, the grantee foundation must provide records to the grantor foundation showing that: (i) the grantee met its 5% minimum payout requirement *before* it received the grant, and (ii) the grantee satisfied its minimum payout requirement for the year in which the grant was received *in addition* to spending the grant.

c. Since most foreign charities are unfamiliar with the minimum payout rules and do not maintain the records necessary to compute it, satisfying the

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26 Treas. Regs. §53.4945-6(c)(2)(i).

27 Treas. Regs. §53.4945-5(a)(4)(iii).

28 Ibid.

"out of corpus" requirement frequently will not be possible. In such a case, the grantor may adopt one of the following approaches:

(1) If the U.S. grantor private foundation's actual charitable distributions for other grants during the year far exceed its 5% minimum payout requirement, it can exercise expenditure responsibility over the grant to the foreign private foundation equivalent and simply not count the grant in meeting the minimum payout requirement. This would allow it to avoid the "out of corpus" rule entirely with respect to the grant.

(2) If the grant to the foreign charity is earmarked for the purchase of capital equipment, and if the purchases are completed within 12 months after the close of the taxable year in which the foreign charity receives the funds, the "out of corpus" rule will be satisfied.

3.7 ANTI-TERRORIST FINANCING GUIDELINES

Making grants for charitable uses abroad has been more complicated since the 9/11 attacks. There were always rules to help guard against the diversion of granted funds. The IRS released voluntary anti-terrorism financing guidelines for non-profits in November of 2002. IRS Announcement 2003-29, 2003-20, I.R.B. 928, and the USA PATRIOT Act of 2001 (P.L. 107-56) have caused practitioners in the area to recommend that grant-making entities:

-- regularly check the Specially Designated Nationals List maintained by Treasury's Office of Foreign Assets Control (OFAC SDN) [see http://www.treas.gov/office/enforcement/ofac.sdn] and the Terrorist Exclusion List maintained by the Department of State in consultation with the Department of Justice (TEL),

-- assess the likelihood of diversion based on the grantee and the circumstances,

-- manage the risk by taking steps most likely to prevent diversion, and

-- keep good records of the organization's grant procedures and risk assessments.

Under the USA PATRIOT Act, the government must prove that the grantor organization knew or intended that the support would be used for terrorist acts or by foreign terrorist groups. If the government does so, those injured by the terrorist act may sue the U.S. grantor organization for treble damages, costs, and attorneys' fees. Good record-keeping will help defend against this and against suspension of exempt status, which may result if the government determines there have been prohibited transactions with "Specially Designated Nationals" or persons designated in Executive

Order 13224, issued on September 25, 2001. Knowingly funding or intending to fund foreign terrorists can also be penalized by up to 15 years in prison, or prison for life if the grantee commits a terrorist act.

Executive Order 13224 allows the government to freeze a nonprofit's assets on a strict liability basis (no knowledge required) if it engages in transactions involving Listed Persons; their property; or unnamed persons who assist, sponsor or provide financial support or humanitarian aid to, or are otherwise associated with Listed Persons.

The Treasury Guidelines Working Group (see Appendix G, Item 3) has recommended that the current guidelines be replaced with a risk-based approach to help grantmakers identify grants with a greater risk of diversion and have their level of due diligence for a grant based on balancing risk factors.

4. SPECIAL CONSIDERATIONS IN ESTATE AND GIFT TAX PLANNING

4.1 GIFT TAX CONSIDERATIONS

4.1.1 Direct contributions to foreign charities are generally deductible for U.S. gift tax purposes under IRC section 2522(a) if (i) the donee is organized for IRC section 170(c) purposes (i.e., religious, charitable, scientific, literary, educational, etc.), (ii) no part of its net earnings inures to the benefit of any individual, and (iii) it is not disqualified from tax exemption under IRC section 501(c)(3) by reason of lobbying or participation or intervention in any political campaign.[29]

4.1.2 An outright gift to a foreign government or its political subdivision which meets the IRC section 2522(a)(2) or (3) requirements is also deductible for gift tax purposes, but only if the gift must be used for charitable, as opposed to public, purposes.

4.2 ESTATE TAX CONSIDERATIONS

4.2.1 An outright bequest to a foreign charity is deductible for estate tax purposes if (i) the charity is organized and operated for IRC section 170(c) purposes; (ii) no part of its net earnings inures to any individual; and (iii) it does not run afoul of the rules against lobbying and participation or intervention in any political campaign.[30]

Example: A decedent domiciled in United States but residing abroad is entitled to a U.S. estate tax

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[29] IRC §§2522(a)(2) and (a)(3).

[30] IRC §§2055(a)(2) and (a)(3).

deduction for a bequest to a school organized in a foreign jurisdiction provided that the school is tax exempt in that jurisdiction and would not otherwise be disqualified under IRC section 501(c)(3).[31]

4.2.2 A testamentary transfer to a foreign government or its political subdivision which meets the IRC section 2055(a)(2) or (3) requirements is also deductible.

Example: The decedent, a U.S. citizen, bequeathed property to a hospital owned by a Canadian county. Use of the property was held to be exclusively for charitable purposes regardless of ultimate ownership by the Canadian county, and the estate tax charitable deduction was allowed.[32]

4.2.3 However, a bequest to a foreign government or political subdivision is not deductible for estate tax purposes unless it must be used for exclusively charitable, not public, purposes.[33] It is therefore critical that the will or trust under which the gift is made specify that it is to be used exclusively for charitable purposes.

a. The IRS has ruled that an unrestricted bequest to a foreign government is not deductible even if that government has adopted an internal policy of requiring all such bequests to be used solely for charitable purposes.[34] The rationale seems to be not only the absence of literal statutory compliance, but also that the foreign government, through internal policy decisions, could redirect the bequest to public use after its initial allocation for charitable purposes.

b. The IRS has also held that a local U.S. probate court's attempt to limit an otherwise unrestricted bequest to a foreign government to exclusively

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31 PLR 9126028.

32 Old Colony Trust Co., 438 F.2d 684 (1st Cir. 1971). Also see Orphanos, 67 T.C. 780 (1977), acq. 1977-2 C.B. 2 (testator's intent that hospital be built for Kerasitsa, Greece, sufficient to vest title in Kerasitsa so IRC §2055 deduction allowed).

33 Rev. Rul. 74-523, 1974-2 C.B. 304.

34 PLR 9004001; PLR 8929001.

charitable purposes was ineffective for claiming the estate tax deduction where doing so conflicted with local controlling law in the applicable foreign jurisdiction.[35]

4.2.4 Under the U.S. treaties with most Western European countries, residents of those countries may claim inheritance tax deductions for bequests to U.S. public charities.

4.3 **TRANSFERS IN TRUST**

4.3.1 No *gift* tax deduction is permitted for an inter vivos gift to a charitable remainder trust unless the remainderman is a U.S. charity.[36] Similarly, no federal *estate tax* deduction is permitted for a testamentary gift to a charitable remainder trust if the remainderman is a foreign charity.[37] Furthermore, IRC section 664 specifies that no *income tax* deduction is permitted for a gift to a charitable remainder trust if the charitable remainderman is not a U.S. charity described in IRC section 170(c).[38]

a. Since a charitable remainder trust generally includes a requirement that each remainder beneficiary be an organization described in sections 170(c), 2055 and 2522, naming a foreign charity will ordinarily simply result in its not receiving any portion of the remainder. As long as the trust contains such a "savings clause," it will still qualify as a charitable remainder trust, but the portion of the remainder of which the foreign charity was the named remainder beneficiary will pass to one or more IRC section 170(c) organizations, thus thwarting the donor's intent. If this occurs, the trustee should attempt to distribute the gift to a U.S. community foundation or "friends of" organization that can, in turn, use the trust funds to make a grant to the foreign charity.

b. Even if an income tax deduction would be available for a direct gift to the foreign charity due to a treaty exception, the deduction will not be permitted if the gift is made via a charitable remainder trust.

4.3.2 Under IRC section 642(c)(1), an estate or trust (other than a charitable remainder trust) is entitled to an income tax deduction for amounts paid or permanently set aside for charitable purposes. The regulations make clear that, as long as the amount is paid or set aside for IRC section 170(c)(2) purposes, it does not matter

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35 PLR 7938001.

36 Treas. Regs. §25.2522(c)-3(e)(2)(v).

37 Treas. Regs. §20.2055-2(e)(2)(v).

38 IRC §§664(d)(1)(c) [charitable remainder annuity trust] and 664(d)(2)(c) [charitable remainder unitrust].

if the donee corporation, trust, community chest, fund or foundation is not created or organized in the United States, any State, the District of Columbia or a U.S. possession.[39] The income tax deduction is available for bequests or other testamentary transfers to otherwise qualifying foreign charities.

4.3.3 IRC section 2055(a)(3) provides that a testamentary gift in trust (other than a split interest trust) for the benefit of a foreign charity or government gives rise to an estate tax deduction as long as the governing instrument restricts the use of the funds to religious, charitable, scientific or educational purposes, or the prevention of cruelty to children or animals. There are numerous cases and rulings allowing the estate tax charitable deduction for testamentary transfers to wholly charitable trusts for the benefit of foreign charities and governments.[40]

5. NONCITIZEN SPOUSE ISSUES

5.1 LIMITED MARITAL DEDUCTION UNDER TAMRA

Resident aliens are generally treated the same as U.S. citizens with respect to federal estate and gift tax. Before the Tax and Miscellaneous Revenue Act of 1988 (TAMRA), U.S. citizens and residents were allowed a deduction for U.S. estate and gift tax purposes for the value of property gifted to a spouse or passing from a decedent to his or her surviving spouse, regardless of the spouse's citizenship. However, Congress was concerned about the ability of a noncitizen spouse to leave the U.S. taxing jurisdiction after having received property from a decedent for which a U.S. marital deduction was claimed, so that U.S. estate tax would never be paid on that property. In order to address this problem, it enacted in TAMRA Code section 2056(d)(1), which disallows the estate tax marital deduction for property in excess of a decedent’s estate tax applicable exclusion amount passing to the noncitizen spouse of a decedent unless such property passes to the surviving spouse in a qualified domestic trust (QDOT). TAMRA also added a new Code section 2523(i), which provides that gifts to a spouse who is not a citizen at the date of gift are subject to U.S. gift tax to the extent such gifts exceed $100,000 per year (plus COLA).

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39 Treas. Regs. §1.642(c)-1(a)(2).

40 See, e.g., Orphanos, supra at note 35 (transfer of real property in trust to build hospital in Greece with accumulated rentals and to enlarge and equip it with proceeds from sale of real property); Kaplun, 436 F.2d 799 (2nd Cir. 1971) (transfer in trust of coin collection to State of Israel, to be permanently displayed in museum); Old Colony Trust, supra at note 35 (transfer to hospital corporation owned by Canadian municipality); National Savings & Trust, 436 F.2d 458 (Ct. Cls. 1971) (transfer in trust to German city to be used for construction or improvement of old age home); PLR 8652035 (transfer in trust of works of art to foreign museums); PLR 8346033 (transfer in trust for use of foreign government in buying and displaying antiques in public museum); PLR 8037126 (transfer in trust to establish scholarships at foreign university for needy students).

5.2 EFFECTIVE DATES

Code section 2056(d)(1) applies to U.S. citizen or resident and nonresident alien decedents dying on or after November 10, 1988, TAMRA's date of enactment. Code section 2523(i) applies to gifts made by U.S. citizens and residents and by nonresident aliens on or after July 14, 1988.

5.3 QDOT REQUIREMENTS

Under Code section 2056A, a trust must meet the following conditions to be considered a QDOT: (i) the trust instrument must provide that at least one trustee be a U.S. citizen or domestic corporation; (ii) no corpus distribution be made unless the U.S. trustee has the right to withhold from the distribution the tax imposed thereon (such withholding does not disqualify the QDOT for the marital deduction); (iii) the trust must meet the security requirements set forth in the Treasury Regulations to ensure the collection of the estate tax imposed on the trust; and (iv) the executor must make an irrevocable election with respect to the trust on the estate tax return. Congressional history indicates that QDOTs must also meet the requirements under Code section 2056 generally applicable to other forms of marital deduction trusts.

5.4 TREASURY REGULATIONS

Final Treasury Regulations under Code section 2056A were issued on August 22, 1995 and on November 27, 1996. These Regulations apply to estates of decedents dying and to gifts made after August 22, 1995. The most recent Regulations provide additional requirements for qualification as a QDOT in order to ensure collection of the section 2056A QDOT estate tax.

5.5 SECURITY REQUIREMENTS BASED ON VALUE OF QDOT

The use of a QDOT to qualify for an estate tax marital deduction is designed to ensure that the tax that is deferred on the death of the first spouse to die will ultimately be collected. To accomplish this goal, the Regulations impose certain requirements, depending on the value of the QDOT.

5.5.1 Large QDOTS

If the value of the QDOT assets on the death of the first decedent is more than $2 million, the trust instrument must require that: (i) at least one trustee be either a bank incorporated and doing business in the United States, or (ii) at least one trustee be an individual or corporate U.S. trustee if one corporate trustee is a U.S. branch of a foreign bank, or (iii) the U.S. trustee furnish a bond in an amount equal to 65% of the fair market value of the trust corpus, determined as of the date of the decedent's death, or maintain a letter of credit, with any such letter of credit issued by a bank incorporated in the United States or a U. S. branch of a foreign bank. The Regulation sections contain specific guidelines outlining the terms of the bond or letter of credit permitted and provide a sample format for each.

5.5.2 Smaller QDOTS

If the value is $2 million or less, and if the U.S. trustee or security arrangements are not elected, the trust instrument of these smaller trusts must expressly provide that no more than 35% of the fair market value of the trust assets, determined annually, may be invested in real property that is located outside the United States.[41]

5.5.3 Security Arrangements

The final Regulations clarify the extent to which the alternate security requirements may be incorporated by reference into the governing document.[42] The final Regulations also make clear that a QDOT may alternate among the three security arrangements, provided that at least one of them is in effect at all times. In particular, a U.S. bank does not have to continue to act as trustee when one of the two other alternatives (bond or letter of credit) is being used.[43]

5.5.4 Residence and Contents

Under the Regulations, the value (as of the date of the deceased spouse's death) of the surviving spouse's principal residence and up to one other residence not rented to others and related furnishings, wherever situated, up to an aggregate value of $600,000 may be excluded for purposes of determining whether the $2 million threshold is exceeded and for purposes of determining the amount of any bond or letter of credit. The exclusion is extended to replacement residences. However, the value of the residence and related furnishings must be included in determining, for QDOT's valued at under $2 million, whether the 35% foreign real property threshold has been exceeded.[44]

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[41] For this purpose, all assets owned by a corporation or partnership with fewer than 16 shareholders or partners are deemed to be owned directly by a shareholder or partner's QDOT to the extent of the QDOT's pro rata share of the assets of the corporation or partnership.

[42] Treas. Reg. §2056A-2(d) and Rev. Proc. 96-54 provide sample language describing the security arrangements, which will satisfy the QDOT requirements. Rev. Proc. 96-54 is effective for trust for which QDOT elections are made after December 9, 1996.

[43] Treas. Regs. §20.2056A-2(d)(1)(i); §20.2056A-2(d)(1)(i)(A).

[44] Treas. Reg. §20.2056A-1(d)(1)(iv).

a. The term "related furnishings" includes standard furniture and furnishings and does not include rare and valuable items or collections or any cars.[45]

b. The $2 million threshold is determined without regard to any indebtedness with respect to the QDOT assets.[46]

5.5.5 Undervaluation of QDOT

If the QDOT assets are undervalued by 50% or more, the marital deduction will be disallowed unless a good faith reasonable cause standard is satisfied.[47]

5.6 ANTI-ABUSE RULE

An anti-abuse rule disqualifies a QDOT (regardless of size) if the trust uses any device or arrangement that has as a principal purpose the avoidance of liability for the deferred estate tax. The IRS will provide guidance in the future under which approval could be requested for an alternate plan to assure collection of the deferred estate tax.

5.7 ANNUAL REPORTING

To qualify as a QDOT, at least one trustee must be a U.S. citizen with a tax home here or a U.S. corporation. The proposed Regulations require the U.S. trustee to file an annual statement (attached to the Form 1041 filed for the trust) which includes a summary of the assets held by the QDOT, together with the fair market value of each asset, as of the end of the trust's tax year.[48]

5.8 QDOT ELECTION

5.8.1 Time for Election

The election to treat a trust as a QDOT must be made by the executor on the last estate tax return filed before the due date or, if a timely return is not filed, on the first return filed after the due date. If the election is made on a late-filed return, it must be made no later than one year after the due date (including extensions).

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45 Treas. Reg. §20.2056A-2T(d)(1)(iii).

46 Treas. Reg. §20.2056A-2T(d)(1)(ii).

47 Treas. Reg. §20.2056A-2T(d)(1)(i)(D).

48 Treas. Reg. §20.2056A-2T(d)(3).

5.8.2 Protective Elections

A protective election may be made if there is a bona fide legal controversy at the time the estate tax return is filed as to the property includible in the gross estate or the property to which the surviving spouse is entitled (e.g., a bona fide will contest). The protective election must identify the specific assets to which the election refers and the specific reason for the protective election.

5.9 IMPOSITION OF ESTATE TAX ON QDOT

A deferred estate tax is imposed when a "taxable event" occurs. Distributions of principal from the trust during the spouse's lifetime are taxable events. However, distributions to the spouse of income, as well as hardship distributions of principal, are exempt from the deferred tax. The tax is also imposed if the trust fails to qualify as a QDOT or the surviving spouse dies.

5.9.1 Definition of Income

The definition of income is modified under the Regulations to prevent the characterization as income of items that would normally be viewed as corpus, such as gain realized on the sale of a trust asset. In the absence of this modification, such items could be allocated to income under the terms of the trust and, thus, possibly be distributed without incurring a deferred estate tax. Thus, capital gains are always treated as principal for purposes of determining the nature of the distribution.

5.9.2 IRD

"Income" does not include "income in respect of a decedent" (IRD) regardless of its characterization under local law. However, the IRS may allow exceptions on a case by case basis.

5.9.3 Distributions to Pay Income Tax

The QDOT tax is not imposed on any distribution to reimburse the spouse for U.S. federal income tax on trust income which the spouse is not entitled to receive (e.g., capital gains). IRC §2056A(b)(15). This will arise if the surviving noncitizen spouse creates the QDOT post-mortem (see Section 4.13 below), in which case the QDOT is a grantor trust as to that spouse for income tax purposes.

5.9.4 Hardship Distributions

A hardship distribution is one made in response to an immediate and substantial financial need relating to the surviving spouse's health, maintenance, education or support, or the health, maintenance, education or support of any person the surviving spouse is legally obligated to support. A distribution is not considered made on account of hardship to the extent that the amount distributed may be obtained from other sources that are reasonably available to the surviving spouse. The final

Regulations clarify that assets such as closely held business interests, real estate and tangible personal property are not considered reasonably available.

5.9.5 Estate Tax Credits

The Code section 2011 state death tax credit and the Code section 2014 foreign death tax credit may be used against the estate tax imposed upon QDOT property pursuant to Code section 2056A(b). IRC §2056(b)(10)(A).

5.10 TAX RATE

The deferred estate tax rate is generally determined by reference to the actual size of the first decedent's estate as increased by the amount involved in the taxable event. However, the highest estate tax rate must be used if the tax imposed on the first decedent's estate has not been finally determined at the time of the taxable event.

5.11 RETIREMENT PLAN AND INDIVIDUAL RETIREMENT ACCOUNT ASSETS

A noncitizen surviving spouse who is the designated beneficiary of a "nonassignable survivor annuity," including an IRA or qualified plan, can qualify the annuity for the marital deduction as though the contractual rights had been transferred to a QDOT. In order to qualify for this estate tax treatment, the noncitizen spouse must agree either (i) to pay the QDOT tax on the corpus portion of each payment received or (ii) to roll over and transfer to a QDOT the corpus portion as received.[49]

5.12 EXCEPTIONS WHERE SURVIVING SPOUSE BECOMES A CITIZEN

The QDOT rules do not apply if the surviving spouse becomes a U.S. citizen before the federal estate tax return for the decedent spouse's estate is filed and the surviving spouse was a U.S. resident at all times between the decedent's death and becoming a U.S. citizen.[50] Under certain conditions, the rules will also cease to apply if the surviving spouse becomes a U.S. citizen after the federal estate tax return is filed. In order to qualify, in addition to becoming a citizen, such spouse must have been a resident of the United States at all times after the death of the decedent and before becoming a citizen, and either (i) no QDOT tax must have been imposed under section 2056A(b)(1)(A) before such spouse became a citizen; or (ii) such spouse must elect, in essence, to treat any taxable distributions from the QDOT as part of the surviving

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[49] Regs. §20.2056A-4(c).

[50] IRC §2056(d)(4).

spouse's tax base for determining the rate of gift and estate tax on future transfers by the surviving spouse.[51]

5.13 POST-DEATH ADDITIONS TO QDOTS

A noncitizen spouse (or conservator, in cases of incapacity; or executor, if the spouse has died) may allow property passing outright from the decedent spouse to qualify for the marital deduction by irrevocably assigning, or actually transferring, it to a QDOT after the decedent's death but before the due date for federal estate tax return, including any extensions. As noted above, a QDOT established post-mortem by the surviving non-citizen spouse will be a grantor trust as to the survivor for income tax purposes.[52]

5.14 JOINTLY HELD ASSETS

Repeal of the gift tax marital deduction for transfers to noncitizen spouses resurrects issues regarding the gift tax implications of creating joint tenancy arrangements (e.g., joint tenancy with a right of survivorship or tenancy by the entirety) where the spouse is not a citizen.

5.14.1 Jointly Held Real Estate

Code section 2040 generally provides that each spouse is deemed to have a 50% interest in property held as joint tenants with a right of survivorship; however, this provision is inapplicable where the surviving spouse is a noncitizen. Therefore, if one spouse is a noncitizen, the termination of such a joint tenancy (either by partition or death) may give rise to a transfer tax unless (i) the amount that each spouse receives (through a right of survivorship or partition) is proportionate to the amount each contributed to the joint tenancy or (ii) the property is transferred to a QDOT.

5.14.2 Jointly Held Personal Property

Each spouse is generally deemed to have retained a 50% interest in personal property contributed to a joint tenancy with a right of survivorship. Accordingly, one-half of any property contributed to such a tenancy is deemed to be retained, and the other one-half is deemed to be a gift at that time. Upon termination of the joint tenancy (through partition, death or otherwise), there would be a taxable transfer to the extent that the amount received exceeds a tenant's one-half interest in the jointly owned property.

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[51] IRC §2056(d)(4), §2056A(b)(12).

[52] IRC §2056(d)(2)(B).

5.14.3 Gift Implications

Where one spouse is a noncitizen, the formation of a joint tenancy may also involve a gift, subject to the $100,000 per year plus COLA exemption. However, in community property jurisdictions, each spouse is generally treated as having supplied 50% of the consideration for real estate, so the community property rules trump the contribution rule in this sense. Moreover, Treasury Regulations section 25.2523(i) – 2(b)(1) provides that the creation of a joint tenancy in real property, as well as any additions to the value of the tenancy in the form of improvements, reductions of indebtedness or otherwise, is *not* deemed to be a transfer of property for gift tax purposes. This rule applies regardless of the proportion of consideration contributed by each spouse *if* the creation of the joint tenancy would otherwise be a gift to the noncitizen donee spouse. The inter vivos transfer provisions apply to gifts made on or after July 14, 1988.

5.15 CHARITABLE REMAINDER TRUST CAN BE A QUALIFIED DOMESTIC TRUST

5.15.1 PLR 9244013

Private Letter Ruling 9244013 indicates that a charitable remainder trust ("CRT") can be a qualified domestic trust.

a. The *inter vivos* unitrust at issue in PLR 9244013 provided a unitrust interest to the trustor for life and, after his death, to his noncitizen spouse. The trustor reserved the right to revoke his spouse's interest by will. The unitrust also provided that, if the spouse succeeded to the life interest, at least one trustee would have to be a U. S. citizen or domestic corporation, and it otherwise met with the technical requirements for a QDOT. There was no completed gift to the noncitizen spouse upon funding of the trust due to the retained right to revoke her interest. The IRS held that if the spouse's interest were not revoked, the marital deduction would be allowed for her interest in the unitrust at the trustor's death, under IRC sections 2056(b)(8) and 2056A(a).

b. Treasury Regulation section 20.2056A-6(b)(3) confirms that a charitable remainder trust can qualify as a QDOT. If the noncitizen spouse is the only individual successor beneficiary (or is the sole beneficiary of a testamentary CRUT), IRC section 2056(b)(8) grants the marital deduction for a surviving spouse's interest in a qualifying charitable remainder trust. Thus, the charitable trust does not have to comply with the QTIP provisions of IRC section 2056(b)(7). The noncitizen spouse is not required to receive all of the income of the CRT, and "terminable interest" issues do not apply to CRTs.

c. Although PLR 9244013 dealt with a unitrust, an annuity trust should also be able to meet the QDOT requirements. The Omnibus Budget Reconciliation Act of 1989 (OBRA '89) deleted the requirement that the surviving noncitizen spouse be entitled to receive all of the income of the QDOT at least annually.

Moreover, Treasury Regulation section 20.2056A-4 treats as a QDOT any annuity or other payment which is includible in the decedent's gross estate and is by its terms payable for life or for a term of years, provided that the QDOT election is made and other QDOT requirements met.

d. Note that any principal distributions to the surviving noncitizen spouse other than for hardship will be taxed under the QDOT rules as they are made.

e. The trustee of a QDOT is required to withhold the QDOT tax on principal distributions other than for hardship, and to pay the estate tax on the principal of the QDOT remaining at the death of the noncitizen spouse. A CRT is not permitted to pay estate taxes or to make payments of the annuity or unitrust amount to other than named beneficiaries. This raises the issue of whether the QDOT withholding requirements might disqualify the CRT. The ruling did not consider this a problem "since the trustee is merely withholding a tax on a portion of the unitrust payment payable to the spouse."

f. If the trustee must withhold income tax on distributions to a noncitizen spouse, it seems that the withholding will not violate the CRT requirement that CRT payments be made only to the named beneficiary, the charity and payments for consideration. Withholding might be required, for example, with respect to distributions of dividends from U. S. corporations, which are subject to 30% withholding unless a lower treaty rate applies.[53]

g. Use of an "income only" or "net income with make-up" unitrust would avoid the taxation of principal distributions to the noncitizen spouse.

5.15.2 Importance of Retained Right to Revoke Spouse's Interest

Gifts to a noncitizen spouse qualify for a $100,000 annual exclusion for gifts of present interests, indexed to reflect increases in the cost of living ($133,000 in 2009). Since a survivorship CRT interest does not qualify as a present interest, a completed gift to a noncitizen spouse upon funding of a CRT does not qualify for this annual exclusion. It is therefore crucial that the trustor render the gift incomplete by retaining the right to revoke it.

5.15.3 Regulations

The Regulations provide that property passing to a QDOT qualifies for the marital deduction if the trust otherwise qualifies as a marital deduction vehicle under IRC section 2056(b)(5) as a life estate with power of appointment, IRC

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53 See PLR 8023049.

section 2056(b)(7) as a QTIP trust (including joint and survivor annuities), or section 2056(b)(8) with the surviving spouse as the only noncharitable beneficiary of a charitable remainder unitrust or annuity trust.

5.15.4 QDOT Estate Tax

The cost of the marital deduction under the QDOT provisions is the QDOT tax imposed on principal distributions (other than for hardship) during the surviving spouse's life, and also on all principal remaining at the survivor's death.[54] As noted above, the tax is computed as if the assets were included in the deceased spouse's estate. The survivor's estate gets credit relief for the QDOT tax.[55]

5.15.5 Charitable Contributions to Offset the QDOT Estate Tax

OBRA '89 amended the QDOT provisions to permit charitable contributions to offset the QDOT estate tax upon the survivor's death. Thus, the corpus will apparently be taxed at the survivor's death, but the QDOT tax should be offset by a charitable deduction for the value of the remainder.

5.16 MARITAL DEDUCTION FOR GIFT OF INTEREST IN POOLED INCOME FUND TO NONCITIZEN SPOUSE

The marital deduction is available for a gift of an interest in a pooled income fund if a QTIP election is made. This election causes inclusion in the surviving spouse's estate, but an offsetting charitable deduction will be available. A surviving noncitizen spouse's interest in a pooled income fund can qualify as a QDOT. The trustee will always be a U.S. corporation, and the donor's Unit Value is unlikely to exceed $2 million. The pooled income fund agreement may have to be modified to meet all of the QDOT requirements.

6. INBOUND CHARITABLE GIFTS

6.1 DIFFERENT RULES APPLY TO NRA'S

6.1.1 Citizens and Resident Aliens Subject to U. S. Tax Rules

The United States treats resident aliens the same as U. S. citizens for purposes of income taxation, estate and gift taxation and the generation-skipping transfer tax, except with respect to the marital deduction for gifts and bequests to noncitizen spouses.

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54 IRC §2056A(b).

55 IRC §§2056(d)(3), 2013.

6.1.2 Different Rules Applicable to Nonresident Aliens

Nonresident aliens ("NRAs") are subject to different U. S. income, estate and gift, and generation-skipping transfer rules from those applicable to U. S. citizens and resident aliens.

6.1.3 Importance of Residence

Because resident aliens and NRAs are taxed differently by the United States, the first step in analyzing the U. S. tax consequences of any transaction involving an alien is to determine whether he is a resident or an NRA. The definition of a U. S. "resident" for income tax purposes is different from the definition of residence for transfer tax purposes.

6.2 OVERVIEW OF U. S. INCOME TAXATION OF NONRESIDENT ALIENS

6.2.1 NRA Status Generally Preferable

Classification as an NRA frequently confers income tax advantages on an alien taxpayer. However, in individual cases, the advantages of resident versus NRA status can vary from year to year.

6.2.2 Residents

The United States subjects U. S. citizens and resident aliens to income tax on their worldwide income at graduated rates.[56] U. S. citizens and resident aliens may use losses, deductions and personal exemptions to reduce their taxable income in the same manner.[57]

6.2.3 Nonresident Aliens

a. Limited U. S. Income Taxation

Unlike U. S. citizens and resident aliens, nonresident aliens (NRAs) are subject to U. S. income tax only on fixed or determinable annual or periodical income derived from U. S. sources ("FDAPI") and other income that is effectively connected with the conduct of a trade or business within the United States ("ECI").[58] While a full discussion of the rules applicable to U. S. income taxation of NRAs is beyond the scope of these materials, the following brief summary will provide

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[56] IRC §1, Treas. Reg. §1.1-1.

[57] IRC §63, §151.

[58] IRC §871.

useful background for analyzing the U. S. tax ramifications of charitable gifts by NRAs. In many cases, foreign donors to U.S. charities cannot claim any tax benefit in their home country, but if they have ECI, they can claim a charitable deduction for U.S. income tax purposes against that ECI.

b. Fixed and Determinable Annual or Periodic Income

(1) FDAPI received from sources in the United States by nonresident aliens is subject to withholding and is taxed at a flat 30% (or lower treaty rate).[59] No U.S. foreign tax credit is allowed to NRAs for foreign taxes paid with respect to FDAPI.[60] Certain interest income from U.S. sources may be received free of tax by nonresident aliens.[61] In addition, capital gains of NRAs not present in the United States for at least 183 days during the taxable year are not subject to U.S. tax.[62]

(2) The term “fixed or determinable annual or periodical income” is merely descriptive of the character of a class of income. If an item of income falls within the class of income considered FDAPI by the Code, it will be so treated regardless of whether that item is paid in a series of payments or in a single lump sum. Income is fixed when it is to be paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained.[63]

(3) Examples of FDAPI and similar items subject to flat rate taxation include: interest, dividends, rents, compensation for personal services paid to an independent contractor, premiums, royalties, annuities, compensation, remunerations, emoluments, gains on sale of obligations attributable to accrued original issue discount (OID), and gains on sale of intangibles with payments contingent on use.[64]

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59 IRC §871(a), §1141(a).

60 IRC §901(b)(4).

61 IRC §871(g), (h) and (i).

62 IRC §871(a)(2).

63 Treas. Reg. §1.1141-2(a)(2).

64 IRC §871(a); Treas. Reg. 1.871-7(b).

c. Effectively Connected Income (ECI)

(1) ECI refers to income of a nonresident alien that is effectively connected with a trade or business in the United States.[65] ECI generally is not subject to taxation or withholding at a flat rate. Instead, it is subject to tax at graduated rates on a net basis after gross income is reduced by allowed deductions.[66] Foreign source losses cannot be deducted against either FDAPI or ECI of an NRA.[67]

(2) Two tests are used to determine if income is ECI: (i) the *asset use test*, and (ii) the *business activities test*. Income will qualify as ECI under the asset use test if the income is derived from assets used in or held for use in the conduct of the taxpayer's trade or business.[68] Such income will be treated as ECI under the business activities test if the alien's business activities in the United States are a material factor in the realization of the income.[69] Generally speaking, activities must be regular and continuous, but an isolated transaction is not invariably precluded from generating ECI.

(3) Note that a foreign person who is a partner in a partnership or a beneficiary of a trust or estate will be treated as engaged in a U.S. trade or business if the partnership, trust or estate is so engaged.[70]

(4) Income from performance of personal services within the United States is ECI if the nonresident alien is an employee. The withholding is similar to the graduated withholding on a U.S. employee's wages. As noted above, if the nonresident is considered an independent contractor, the compensation is FDAPI and the rate is a flat 30 percent.

(5) Gain or loss of a nonresident alien from the disposition of a U.S. real property interest (USRPI) is treated as effectively connected with the conduct of a trade or business within the United States. The term USRPI includes both direct interests (other than solely as a creditor) in real property located in the United States and interests (other than solely as a creditor) in domestic U.S. real

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[65] Treas. Reg. §1.864-4(b).

[66] IRC §871(b), §873.

[67] IRC §873.

[68] IRC §864(c)(2)(A).

[69] IRC §864(c)(2)(B).

[70] IRC §875.

property holding corporations.[71] A detailed discussion of the highly technical provisions of the Foreign Investment in Real Property Tax Act (FIRPTA) that govern such dispositions is beyond the scope of these materials.

(6) In general, income can be ECI only if it has a U.S. source, but there are three important exceptions. Certain items of foreign-source income and gains may be taxable by the United States if they can be attributed to a U.S. office or other fixed place of business. The specific types of income that may be treated as effectively connected are limited essentially to income from three categories:

(a) Certain dividends, interest, and securities gains;

(b) Certain rents, royalties, and gains from intangible property; and

(c) Sales of inventory unless the inventory was sold for use or consumption outside the United States, and a foreign office of the taxpayer participated materially in the sale.

A corollary to the taxation of foreign-source income is that a credit against U.S. tax is provided for any foreign income and related taxes paid with respect to any effectively connected income taxed in the United States.[72]

6.2.4 United States Residence for Income Tax Purposes

Code section 7701(b) provides a statutory definition of resident alien for income tax purposes and is generally applicable for tax years beginning after 1984. Under this statutory definition, an alien individual is treated as a resident of the United States for a calendar year if the individual either:

- Is a lawful permanent resident of the United States at any time during the calendar year (the "green card test"); or

- Satisfies a "substantial presence test" based on time spent in the United States during the calendar year and other factors.

[71] IRC §897(a), §897(c)(1)(A).

[72] IRC §906.

a. The Green Card Test

An alien individual is considered a lawful permanent resident of the United States at any time if (i) the individual has been accorded the privilege of residing in the United States as an immigrant in accordance with the immigration laws, and (ii) such status has not been revoked or administratively or judicially determined to have been abandoned.[73] The effect of this latter rule is that an individual who informally abandons resident status or who fails to return to the United States frequently enough to qualify for reentry may continue to be taxed as a resident even though not legally entitled to enter the United States.

An alien with lawful permanent resident status is treated as a resident for tax purposes without regard to time spent in the United States.

b. The Substantial Presence Test

(1) <u>The Objective Substantial Presence Test</u>

(a) An alien will be considered a resident of the United States in a tax year under the "objective substantial presence test" if the individual was present in the United States for 183 days or more during the calendar year.

Example: X is an alien individual. During 2011, X is present in the United States for 183 days. The results for 2011 are (1) satisfaction of the objective substantial presence test, (2) classification of X as a resident alien, and (3) income taxation of X on worldwide income.

The substantial presence test can also be satisfied if the alien spends at least 31 but fewer than 183 days in the United States during the current year. This occurs for those aliens who repeatedly spend significant amounts of time in the United States. Whether an alien, over a period of years, satisfies these criteria is determined by a formula, weighted toward the current taxable year. The criteria are deemed satisfied if application of the formula equals or exceeds 183. The formula equals the sum of (i) the total days present during current calendar year, (ii) one-third of days present during the immediately preceding year, and (iii) one-sixth of days present during the second preceding year.[74]

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73 IRC §7701(b)(6).

74 IRC Section 7701(b)(3).

Example: Y is an alien individual. Y's current taxable year is 2011. During 2011, Y was present in the United States for 120 days. For 2010 and 2009, Y was present for 150 and 60 days, respectively. Applying the formula, the result is:

Current year	(2011)	120 days
1st preceding year	(2010) 1/3 x 150 =	50 days
2nd preceding year	(2009) 1/6 x 60 =	10 days
TOTAL		180 days

Because the result of the formula is less than 183 days, the objective substantial presence test is not satisfied and Y is a nonresident alien for 2008.

(b) Highly technical rules apply to determining what constitutes a day of presence in the United States.[75] For example, special rules apply to regular commuters from Canada or Mexico. An individual who travels to employment in the United States and returns to a residence in Canada or Mexico during a 24-hour period will not be considered to be present in the United States during such commute days, provided that more than 80% of the individual's workdays during the year are made up of such commute days.[76]

(2) The Subjective Substantial Presence Exception

An alien who has been present in the United States for less than 183 days during the current year but who otherwise satisfies the objective substantial presence test because of time present in the United States in prior years may be exempted from treatment as a resident if he or she is able to establish both:

- A tax home in a foreign country; and
- A closer connection to that foreign country.[77]

(a) The IRS's traditional position that an individual's "tax home" is his regular or principal (if more than one regular) place of

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75 See the Treasury Regulations under IRC §7701 for these rules.

76 Treas. Reg. §301.7701(b)-3(e).

77 IRC §7701(b)(3).

business, or if the individual has no regular or principal place of business because of the nature of the business, then at his regular place of abode in a real and substantial sense.[78]

(b) A "closer connection" to a foreign country is demonstrated by facts and circumstances relating to the alien's personal life, such as the location of the individual's (i) home, (ii) family, (iii) belongings, (iv) organizations, (v) personal bank accounts, (vi) drivers license, (vii) the country of residence used by the individual on forms and documents, (viii) the types of forms and documents filed by the individual, and (ix) where the individual votes.[79]

Example: The facts are identical to those in the preceding example except that during the second preceding year (2009), Y was present in the United States for 90 rather than 60 days. Applying the formula, the result is:

Current year	(2011)	120 days
1st preceding year	(2010) 1/3 x 150 =	50 days
2nd preceding year	(2009) 1/6 x 90 =	15 days
TOTAL		185 days

Thus, while Y was present in the United States for less than 183 days during the current year, application of the formula (due to 2010 and 2009–the two preceding years) reaches and exceeds the 183 mark. Ordinarily, this would lead to satisfaction of the substantial presence test. However, Y is able to satisfy the exception by establishing existence of a tax home in a foreign country and a closer connection to that country than to the United States.

c. Coordination With Income Tax Treaties

The regulations provide that if an individual is treated as a resident of the United States under the statute and also as a resident of a foreign country pursuant to a treaty, the treaty residence rules will apply for treaty purposes.[80] If an individual claims a benefit as a nonresident of the United States under a treaty, he or she will be treated as a nonresident for all purposes of computing the individual's U.S. income tax with respect to that taxable year.

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78 Treas. Reg. §301.7701(b)-2(c)(1).

79 Treas. Reg. §301.7701(b)-2(d).

80 Treas. Reg. §301.7701(b)-7(a).

If an eligible individual does not choose to claim treaty benefits with respect to any item of income covered by the treaty, he or she will generally be taxed as a resident.

6.2.5 Overview of U. S. Transfer Taxation of Nonresident Aliens

a. Taxable Estate

For U.S. federal estate tax purposes, a nonresident alien's gross estate includes only property situated or deemed situated in the United States at his or her death. Certain expenses, losses, debts, taxes and charitable transfers are deducted to arrive at the taxable estate. Under the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), U.S. situs property passing from a nonresident alien to a surviving spouse can qualify for the marital deduction, subject to the same requirements that apply to property passing from a U.S. citizen or resident to a surviving spouse, including the qualified domestic trust rules which apply if the surviving spouse is not a U.S. citizen.

b. Estate Tax Rates and Credits

The U.S. estate of a nonresident alien is subject to estate tax at the same rates as estates of U.S. citizens and residents. Certain tax credits are allowed, the most significant being a $13,000 estate tax credit (which exempts only the first $60,000 of the estate from U.S. estate taxes) and a credit for state death taxes.

c. Gift Tax

Nonresident alien donors are subject to gift tax under the same rules and at the same rates as U.S. citizens and residents except that, unlike citizens and residents, (i) a nonresident alien is taxed only on gifts of U.S. real property and tangible personal property situated in the United States at the time of the gift, (ii) pursuant to IRC section 2513(a)(1), the donor may not split gifts with his or her spouse, and (iii) pursuant to IRC section 2505(a), no lifetime gift tax exemption is available. An NRA can make annual exclusion gifts under IRC section 2305(b) and tax-free gifts for education and medical expenses under IRC section 2503(c).

d. Treaties

Tax treaties vary these rules with respect to aliens domiciled in signatory countries at the time of gift or death, and with respect to the availability and application of the credit for foreign taxes in the case of U.S. citizens and resident aliens. Applicable treaty rules are discussed at length below.

6.2.6 United States Residence for Transfer Tax Purposes

a. Domicile Test

For estate and gift tax purposes, a resident is one who, at the time of his or her death or at the time of his or her gift, is domiciled in the United States. A person is a U.S. domiciliary if he or she lives in the United States, even for a brief period of time, with the intent to remain indefinitely.[81]

b. Multiple Domicile

An alien could be domiciled in the United States and in one or several other countries. Treaties address in various ways the potential for double taxation of estates that may result, as discussed further below in the separate sections on treaty fiscal domicile rules and credits.

(1) Foreign Death Tax Credit

A number of treaties either leave the question of domicile to be determined under the local laws of the two countries or have no provision regarding domicile. Under such treaties, an estate may be subject to taxation of worldwide assets by two countries, but the tax authorities of the signatories all allow tax credits for taxes on property situated in the other country.

(2) Treaty Domicile Rules

The more modern treaties contain provisions to avoid having each of the signatories tax the individual as a domiciliary.

6.2.7 Estate Taxation of Nonresident Aliens

a. Gross Estate

(1) U.S. Property Only

The gross estate of a nonresident alien includes only property situated in the United States.[82] For this purpose, the term "United States" means only the 50 states and the District of Columbia.[83]

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81 Treas. Reg. §20.0-1(b)(1); §25.2501-1(b).

82 IRC §21B.

83 IRC §7701(a)(9).

(2) Applicable Code Sections

The gross estate of a nonresident alien is determined under the same Code sections (i.e., Code sections 2031 through 2046, inclusive) as that of a citizen or resident alien, except that special use valuation under Code section 2032A is not available.

(3) Situs Rules

Property transferred during life that would be includible under Code sections 2035-2038, inclusive, is "deemed to be situated" in the United States if it was situated there at the time of the gift or at the time of the decedent's death. Code sections 2035 through 2038 dictate inclusion in the gross estate of certain property transferred within three years of death (§2035); transfers with retained life estates, certain retained rights to direct the ultimate disposition of transferred property, and retained rights to vote stock of a controlled corporation (§2036); transfers taking effect at death (§2037); and revocable transfers (§2038). The estate tax situs rules also apply in determining situs at the time of gift.

(4) Equitable Ownership

As with decedent citizens, property which a nonresident decedent alien legally owned or possessed at death is not includible in his or her gross estate if he or she was not the beneficial or equitable owner as well, and property held in the name of a third person for the decedent is includible. It may be necessary to analyze foreign statutes, case law and decrees, and the nature of foreign organizations (which may not have exact U.S. counterparts), in order to determine equitable ownership.

(5) Community Property

A decedent who was a national and a resident of a community property country is considered to have owned only half of community interests in U.S. property.

(6) Grantor Trusts and General Powers of Appointment

The value of the U.S. corpus of any revocable or grantor trust of a nonresident alien decedent will be included in his or her gross estate for U.S. estate tax purposes, as will the value of his or her vested beneficial interest in the U.S. corpus of any trust. Moreover, a general power of appointment by an NRA over property deemed situated in the United States for U.S. estate tax purposes will cause inclusion of such property in his or her U.S. estate.

(7) Partnerships

U.S. situs property owned by a foreign partnership should not be included in the U.S. estate of a decedent alien partner if, under foreign law, the partnership is regarded as an entity separate from its partners and if the death of the decedent did not terminate the partnership. The treatment of a partnership interest in a partnership organized and doing business in the United States is unclear. However, the IRS has ruled that the situs of a partnership is not determined by reference to the situs of its assets, but rather by where the partnership conducts its business.[84]

b. Estate Tax Deductions

(1) Expenses, Losses, Debts and Taxes

Estates of nonresident aliens are entitled to deduct a portion of the types of expenses, losses, indebtedness and taxes described in Code sections 2053 and 2054.[85] The deductible portion of such items is determined by a fraction the numerator of which is the value of the gross estate situated in the United States, and the denominator of which is the value of all property included in the gross estate.[86] The deductible amounts may have been incurred or expended within or without the United States. As a condition to allowance of any such deductions, the estate tax return must disclose the decedent's gross estate situated outside the United States.[87]

(2) Charitable Deduction

With some exceptions, the estates of nonresident aliens are allowed a deduction for charitable contributions identical to that permitted citizen and resident estates under Code section 2055.[88]

(a) Bequests to corporate charities are deductible only if the corporation is domestic.

(b) Bequests to trusts are deductible only if the bequests are to be used within the United States.

(c) Other limitations appear in IRC section 2106(a)(2)(A) and are discussed in detail later in these materials.

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[84] Rev. Rul 55-701, 1955-2 C.B. 836.

[85] IRC §2106(a)(1); Treas. Reg. §20.2106-1, §20.2106-2.

[86] Treas. Reg. §20.2106-2(a)(2).

[87] Treas. Reg. 20.2016-1(a)(1).

[88] IRC §2106(a)92)(A); Treas. Reg. §20.2106-2(a)(2).

(3) Marital Deduction

Code section 2056(b) allows the estate tax marital deduction for U.S. situs property passing from a nonresident alien decedent to a surviving spouse who is a U.S. citizen or resident. However, section 2056(d) provides that any property passing to a noncitizen surviving spouse cannot qualify for the deduction unless it passes to a qualified domestic trust (QDOT). The QDOT provisions are discussed in the separate section on the marital deduction.

c. Treaty Variations on Estate Taxation of Nonresident Aliens

The United States has entered into estate tax treaties with a number of countries. While the specific details of each such treaty are beyond the scope of this outline, practitioners should be aware that many treaties contain situs rules which vary from those of the Code and benefit estates covered by the treaty provisions. For example, treaties generally exempt from U.S. tax the gifts and estates of domiciliaries of the treaty partner, other than U.S. citizens, except for (i) real property located in the United States and (ii) business property of a permanent establishment in the United States and assets pertaining to a fixed base used for the performance of independent personal services. In addition, some treaties add to the deductions available to the estates of nonresidents, and some require the estates of nonresidents to be allowed a proportion of any credit available to a U.S. domiciliary. Modern treaties generally provide for nondiscriminatory treatment by one country with respect to citizens or nationals of the other country. However, such treaties usually confirm that for purposes of one country's tax, its nonresident citizens are not in the same circumstances as nonresident citizens of the other country. This rule is intended to preserve U.S. taxation of its citizens domiciled abroad. Treaty rules are more fully discussed below, and an entire section of these materials is devoted to charitable deduction provisions of U. S. estate and gift tax treaties.

6.2.8 Gift Taxation of Nonresident Aliens

a. Taxable Gifts

Gifts by nonresident aliens of (i) tangible personal property located in the United States at the time of the gift and (ii) U.S. real property are subject to U.S. gift tax.[89] Gifts of intangible property by NRAs are not subject to U.S. gift tax.[90] The same gift tax rates apply to gifts of nonresidents as gifts of U.S. citizens and residents but, absent a treaty provision, no gift tax credit is allowed.

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89 IRC §2511(a).

90 IRC §2501(a)(2).

b. Gift Tax Deductions and Exclusions and Gift-Splitting

Nonresident aliens are entitled to the annual gift exclusions under Code section 2503(b) for gifts to donees other than their spouses. There is also an annual gift tax exclusion for gifts made on or after July 14, 1988 to a spouse who is not a U.S. citizen.[91] This exclusion is indexed to reflect increases in the cost of living. In 1999 and earlier, it was $100,000. In 2011, it is $139,000. The unlimited marital deduction is available for gifts of U.S. tangible personal property or real property by nonresident aliens to U.S. citizen spouses. Charitable deductions are generally limited to gifts to domestic corporate charities and to charitable trusts which are to use the gift within the United States.[92] Nonresident aliens may not elect to split gifts with their spouses since Code section 2513(a)(1) requires that both donor and spouse be U.S. citizens or residents.

c. Startling New Transfer Tax Provisions

Gifts of intangible property by a nonresident alien to a U.S. donee are not generally subject to U.S. gift tax, though the donee must report such gifts on IRS Form 3520 if their value in any one calendar year exceeds, in the aggregate, $10,000. Under the Heroes Earnings Assistance and Relief Tax Act passed on June 17, 2008, new Code section 2801 imposes a new transfer tax on a U.S. citizen or resident who receives a gift or bequest of property after June 17, 2008 from a “covered expatriate” under the mark-to-market deemed sale rules described in section 7.2.4(d) of this outline. A U.S. citizen or resident who receives property, directly or indirectly, by gift or inheritance from a covered expatriate after the expatriation date must pay tax on the gift or bequest value at the greater of the highest U.S. estate tax rate in effect (45% for 2008-9) and the highest rate on the date of receipt. The tax also applies to a U.S. domestic trust recipient; the tax is imposed on a foreign trust when it distributes income or capital to a US citizen or resident.

The transfer tax applies only to the gift or bequest value in excess of the annual U.S. gift tax exclusion ($13,000 for 2011) and is reduced by any gift or estate tax paid to a foreign country. The new transfer tax does not apply to (i) property shown as a taxable gift on a timely filed U.S. gift tax return for the covered expatriate; (ii) property included in the covered expatriate's gross estate shown on a timely filed estate tax return; and (iii) property for which a U.S. estate or gift tax charitable deduction or marital deduction would be allowed if the transferor were a U.S. person.

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91 IRC §2523(i).

92 IRC §2522(b).

6.2.9 Generation-Skipping Transfer Tax

a. U.S. Citizens and Residents

If a U.S. citizen or resident alien creates a generation-skipping trust, the generation-skipping transfer tax ("GST") will be payable on a taxable termination or distribution with respect to trust assets located anywhere in the world even though the trustees, income beneficiaries and remaindermen are all nonresident aliens.

b. Treasury Regulations Affecting Nonresident Aliens

Treasury Regulation section 26.2663-2, effective for transfers made on or after December 24, 1992, clarifies the treatment of generation-skipping transfers ("GSTs") made by nonresident aliens.

(1) Rules Applicable to Nonresident Aliens

Nonresident aliens are entitled to claim the same GST exemption as U.S. citizens and residents and are subject to the automatic allocation of exemption to generation skipping transfers. The Regulations establish two rules for the applicability of Chapter 13 of the Code, which contains the GST rules, to transfers by nonresident aliens.

(2) Transfer Must Be Subject to U.S. Gift or Estate Tax

The GST tax is applicable to transfers at death by nonresident aliens to the extent that the transferred property is situated in the United States for purposes of the estate tax laws. The GST tax also applies to lifetime transfers to the extent that the transferred property is situated in the United States for purposes of the gift tax laws and is subject to tax under Code section 2501(a). Subsequent taxable distributions and taxable terminations with respect to property held in trust are subject to the Chapter 13 GST tax rules if the original transfer of the property by the nonresident alien to the trust was subject to Chapter 13.[93]

(3) Anti-Abuse Rule

An "anti-abuse" rule makes Chapter 13 applicable without regard to any transaction or other activity if the effect of such transaction or activity is to transfer U.S. situs property from the transferor to the transferee.

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[93] Treas. Reg. §26.2663-2(b).

c. Treaty Rules

The estate and gift tax treaties presently in effect either expressly refer to the GST or provide that they will cover subsequently enacted taxes which are of a substantially similar character to the taxes expressly covered by treaty. For these purposes, the GST should be "substantially similar" to the estate tax. However, the general situs rules which serve to exempt many types of U.S. property from estate taxation under the various treaties may not shield such property if it is owned by a generation-skipping trust.

6.2.10 Transfer Tax Situs Rules Regarding Property of Nonresident Aliens

a. Generally

The question of where property is deemed to be situated at the time of a gift, death or generation-skipping transfer is crucial in the area of taxation of nonresident aliens. The situs question may be complicated by conflict over whose law determines the categorization of a property interest. Furthermore, additional complications arise because situs rules in the Code and Treasury Regulations may conflict with treaty situs rules.

b. Special Code Exclusions

For policy reasons, certain types of property which are clearly situated in the United States are treated as having a situs outside the United States, so a nonresident alien's estate incurs no *estate tax* on their transfer.[94]

(1) Deposits with Domestic Banks

Deposits with domestic banks are treated as situated outside the United States unless the deposits are effectively connected with the conduct of a trade or business within the United States.[95]

(a) Cash held by a brokerage firm does not have a foreign situs under this provision.[96]

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94 IRC §2105.

95 IRC §2106(b); §871(i).

96 Rev. Rul. 56-421, 1956-2 C.B. 602.

(b) Deposits in a foreign branch of a U.S. bank are always foreign situs, whether or not the deposits are effectively connected with a U.S. trade or business.

(c) Deposits in a domestic banking branch of a foreign corporation have a foreign situs unless effectively connected with a U.S. trade or business, in which case they have a U.S. situs.[97]

(d) The term "deposit" includes money left in checking, savings, unrestricted agency accounts and certificates of deposit, but does not include loans made to a bank or cash in a bank's safety deposit box. It also includes accrued and unpaid interest on deposits. Deposits in the name of an agent or custodian are considered deposits of the alien principal.

(2) <u>Deposits with Domestic S&L's</u>

Deposits or withdrawable accounts of a nonresident alien with a domestic savings and loan association are treated as foreign situs property for estate tax purposes if not effectively connected with the conduct of a trade or business in the United States and if amounts paid as interest are deductible by the paying institution under Code section 591 (determined without regard to Code section 265).[98]

(3) <u>Certain Debt Obligations</u>

Portfolio debt obligations issued by U.S. obligors after July 18, 1984, the date of enactment of the Tax Reform Act of 1984, and debt instruments of issuers who realize less than 20% of their income from U.S. sources, are deemed to be property situated outside the United States.[99] Most bonds, therefore, do not have a U. S. situs.

(4) <u>Amounts Held by Domestic Insurance Companies</u>

Amounts held by an insurance company under an agreement to pay interest thereon are deemed to be foreign situs property even if the insurance company is a domestic corporation, if the amount is not effectively connected

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97 IRC §2104(c), §2105(b).

98 IRC §2105(b)(1); §871(i).

99 IRC §2105(b)(3).

with the conduct of a U.S. trade or business by the recipient.[100] This rule includes prepaid premiums held by U. S. insurance companies.[101]

(5) Life Insurance Proceeds

For estate tax purposes, the proceeds of life insurance policies on the life of the decedent are deemed to be property situated outside the United States whether the insurer is a domestic or foreign company.[102] For gift tax purposes, the situs of life insurance policies is immaterial because gifts by nonresident aliens of intangibles situated in the United States are not taxable. Note that this rule does not apply to life insurance on another owned by the decedent NRA; if issued by a U. S. insurer, it is includible in the NRAs gross estate.

(6) Annuities

For estate tax purposes, rights in an annuity contract enforceable against a U. S. company have a U. S. situs.[103]

(7) Works of Art

Works of art owned by a nonresident alien which are in the United States at his or her death are, for estate tax purposes, deemed situated outside the United States if they were imported solely for exhibition, were loaned to a nonprofit public gallery or museum, and were on exhibition or en route to or from exhibition at death.[104] There is no corollary gift tax situs rule; if a nonresident alien makes a completed gift of a painting while it is in the United States on public exhibition, the gift will be taxable.

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100 IRC §1105(b)(1).

101 PLR 8543046.

102 IRC §2105(a).

103 See Guaranty Trust Co. of N.Y., 16 BTA 314 (1929); Chase National Bank of N.Y., 2 P-H Memo BTA 384 (1933).

104 IRC §2105(c); Treas. Reg. §20.2105-1(b).

6.2.11 Other Situs Rules

a. Real Property

The situs of real property is determined by its physical location.[105] Issues arise regarding whose law governs the classification of property and what interests in land are real property under the governing law. For example, security interests and leaseholds have generally been held not to be real property. Where state law prohibits nonresident aliens from owning real property, or certain types of real property, such a person may be able to own realty indirectly through a domestic corporation, in which case Code or treaty rules regarding the situs of stock would control unless the corporation were treated as a custodian or nominee of the shareholder.

b. Tangible Personal Property

The situs of tangible personal property (except works of art on loan for public exhibition) is determined by its physical location at the time of death.[106] Currency is generally treated as tangible personal property.[107] However, in an exception to the general rule, mere transitory physical presence of tangible personality within the United States at the time of death is not sufficient by itself to cause it to be situated within the United States for estate tax purposes.[108]

c. Stock

Stock of a domestic corporation is deemed situated within the United States, and stock of a foreign corporation without the United States, regardless of the location of the stock certificates, stock transfer offices or the sources of its income.[109] A U.S. brokerage account holding a portfolio of foreign stocks does not have a U.S. situs.

d. Interests of Trust Beneficiaries

The right of an income beneficiary of a nongrantor trust to income on hand and accrued income at date of death is a claim against the trustee and,

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105 Treas. Regs. §20.2104-1(a), §20.2105-1(a)(1), §25.2511-3(b)(1).

106 Treas. Regs. §20.2104-1(a)(2); §20.2105-1(a)(2); §25.2511-3(b)(1).

107 Treas. Reg. §20.2105-1(a)(2); Rev. Rul. 55-143, 1955-1 C.B. 465.

108 Delaney v. Murchie, 177 F.2d 444 (1st Cir. 1949).

109 IRC §2104(a); Treas. Regs. §20.2104-1(a)(5); §20.2105-1(f); Rev. Rul. 54-407, 1954-2 C.B. 657.

thus, probably has its situs at the residence or jurisdiction of incorporation of the trustee. Any other sort of trust interest would seem to have its situs at the situs of the underlying assets.

e. Retirement Benefits

Retirement benefits are probably governed by the rules applicable to debts, so that the situs is where the pension trustee resides.

6.2.12 Treaty Situs Rules

The United States has gift and estate tax treaties with various countries which contain situs rules that apply when the signatory country seeks to impose tax on the basis of situs alone. The older treaties contain a specific rule for each of many categories of assets, while the more recent treaties generally refer to only three categories of assets: business-related assets connected with a permanent establishment, tangible assets and all other property. When treaty situs rules are applicable, they override Code situs rules. However, the treaties all provide, expressly or by inference, that if the estate or gift tax computed under the treaty rules regarding situs, exemptions, deductions and credits is larger than had the Code rules applied, then the tax imposed will be the lower tax computed under the Code. A donor or executor may elect the treaty rules or the Code rules, but not a combination of the two. In the absence of a treaty, it is uncertain whether U.S. law or foreign law governs the classification of a property interest. Where a treaty is involved, the law of the country imposing tax on the basis of situs governs.

6.3 GIFT TAX CREDIT UNDER CERTAIN TREATIES

Some treaties provide that a U.S. citizen or resident is entitled to a full or partial gift tax credit against his or her U.S. gift tax for gift tax paid in the other treaty country with respect to the same gift.

7. SPECIAL RULES FOR CONTRIBUTIONS BY NRAs TO U. S. CHARITIES

7.1 MUST RELATE TO EFFECTIVELY CONNECTED INCOME

As discussed above, nonresident aliens (NRAs) are subject to U. S. income tax only on fixed or determinable annual or periodic income derived from U. S. sources ("FDAPI") and other income effectively connected with the conduct of a trade or business within the United States ("ECI"). Generally, deductions from U. S. income tax are available to NRAs only if and to the extent they are connected with ECI. If the NRA has ECI, he may claim deductions for charitable contributions under IRC section 170 only against that ECI. If an NRA engaged in a trade or business derives FDAPI which is not effectively connected, no deductions whatsoever are available as to that income.[110] In order to claim a deduction against ECI, the NRA must file a true and accurate timely return with the IRS.[111]

7.2 OFFSETTING ECI GAIN WITH CHARITABLE DEDUCTION

The automatic availability of charitable deductions from ECI provides planning opportunities. A charitable deduction may be claimed in the year of the contribution. Therefore, a larger than normal contribution may be made in those years when the NRA wants to generate a deduction to offset gain. The deductibility of charitable contributions by NRAs to U. S. charities is subject to the usual percentage limitations under IRC section 170(b)(1). It may also be limited if the contribution is to be used in a foreign jurisdiction, as discussed above. IRC §170(c). However, the gain to be offset by the deduction could be substantial, such as that derived from the disposition of a U. S. real property interest ("USRPI"). Gain derived by an NRA from the disposition of USRPI is treated as effectively connected with the conduct of an artificial trade or business under IRC section 897(a)(1), but the gain may be minimized by offsetting losses and by deductions. The losses and deductions must arise from ECI.

7.3 FOREIGN "REVERSE FEEDERS"

If a foreign donor to a U.S. charity has no ECI for the year of the donation, the donor may qualify for income tax benefits in his or her home jurisdiction. Except for rare treaty exceptions, though, other countries do not allow their residents income tax benefits for gifts to foreign charities (though the European Union is trying to conform tax benefits for charitable gifts across its borders).

7.3.1 If the foreign donor does not make a gift directly to a U.S. charity but instead gives it to a community foundation or other "reverse feeder" tax exempt organization in the donor's home jurisdiction, and that foreign charity then re-grants the gift to a U.S. charity, the foreign donor may qualify for income tax benefits in the jurisdiction in which the donor resides.

7.3.2 As with gifts made by U.S. donors to U.S. charities which then re-grant the funds to foreign charities, there can be no earmarking; the foreign charity must retain dominion and control over the use of the funds. The number of community foundations around the world is growing rapidly, and those foreign community foundations will generally take in gifts from local donors to a donor advised fund equivalent and then re-grant the gift to a U.S. charity at the donor's request. This may allow the foreign donor to claim income tax benefits in his or her home jurisdiction. Of

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110 Treas. Reg. §1.873-1(a)(1).

111 IRC §874(a).

course, the foreign community foundation charges a fee in connection with the donor advised fund, and it is generally higher than normal due to the fact that the community foundation will not hold the funds for long.

7.3.3 Some resources for this are Tides Foundation /www.tidescanada.org (Canada), the Asia Foundation's Give2Asia donor advised fund program /www.give2asia.org (which can take in funds in various Pacific Rim jurisdictions, including Korea), The Border Partnership /www.borderpartnership.org (Mexico), and Charities Aid Foundation-U.K. /www.CAFonline.org.

7.3.4 The advisor must, however, be aware of potential foreign gift tax ramifications, as well as U.S. gift tax ramifications if the gift is of U.S. real property or tangible personal property located in the U.S. at the time of the gift.

8. TREATY EXCEPTIONS

8.1 HISTORICAL U.S. RESISTANCE TO TREATY EXCEPTIONS

The United States has long resisted approving income tax treaty provisions which override the general statutory limitations on deductions for contributions by U.S. citizens and residents to foreign charities.

8.1.1 This U.S. policy has been questioned in a number of treaty negotiations, including those with Honduras and Brazil.

8.1.2 The reason for the policy was explained by the Senate Foreign Relations Committee when it rejected proposed Article 22 of the U.S.-Brazil Tax Treaty:

> The only United States tax treaty now in force which contains a similar provision is the treaty with Canada, and the Committee does not believe that the practice of allowing tax deductions to Americans for contributions to organizations in foreign countries should be expanded by the tax treaty process. The Committee notes that the same objective can be accomplished through domestic law, and does not believe that a proliferation of these activities should be encouraged by treaty. This is particularly true when one considers that the American taxpayer would be subsidizing such charitable contributions to the extent of the tax deduction which would be allowed. Moreover, in the Committee's view, there is no justification for supporting charities organized abroad until positive steps have been taken to correct the abuses found in some of our domestic tax-exempt foundations.[112]

[112] H. Rpt. No. 1860, 75th Cong., 3d Sess., pp. 19-20 at 1939-1 C.B. (Part 2) 728,742.

8.2 RARE EXCEPTIONS MAY SIGNAL POLICY SHIFT

Recent United States-Canada, United States-Mexico and United States-Israel tax treaty developments indicate that the United States has finally relaxed its policy of disallowing income tax deductions for direct contributions to foreign charities.

8.2.1 The full significance of these developments is unclear. Canada and Mexico raise unique policy issues because of our shared borders. Israel also enjoys a special relationship with the United States.

8.2.2 As more nations adopt U.S.-type rules governing the qualification and oversight of charitable organizations, the United States may expand its willingness to adopt such treaty exceptions. Any such policy shift will have major implications for charitable organizations and donors around the world.

8.2.3 U.S. restrictions on income tax deductions for gifts to foreign charities generally dissuade U.S. donors from making gifts benefiting specific foreign causes. Since treaty provisions allowing deductions for direct gifts to foreign charities raise the comfort level of donors, such provisions consistently result in an increase in the number and value of cross-border charitable gifts.

8.3 U.S.-CANADA TREATY: THE FIRST BREAKTHROUGH

The U.S.-Canada income tax treaty which came into effect on January 1, 1985[113] represented an unprecedented breakthrough in U.S. policy regarding cross-border gifts. Under this treaty, income tax deductions are generally allowed for direct gifts by U.S. donors to Canadian charities and vice-versa.

8.3.1 Paragraph 5 of Article XXI of the U.S.-Canada treaty provides that contributions by a U.S. citizen or resident to a Canadian tax-exempt organization which could qualify in the United States to receive deductible contributions if it were a U.S. organization are deductible against the donor's *Canadian-source income*, subject to U.S. percentage limitations.

a. This exception does not permit any deduction if the U.S. donor has no Canadian income.

b. A more generous exception permits a deduction against a U.S. donor's *U.S.-source income* (again, subject to U.S. percentage limitations) for

[113] Convention Between the United States and Canada With Respect to Taxes on Income and Capital, effective 1/1/85. 1986-2 C.B. 258. This treaty was signed on 9/26/80 and has subsequently been amended by 1983, 1984, 1995 and 2008 protocols.

contributions to a Canadian college or university at which the donor or a member of the donor's family is or was enrolled.

8.3.2 Paragraph 6 of Article XXI of the U.S.-Canada treaty provides for reciprocal credits for gifts by Canadian residents to U.S. tax-exempt organizations that could qualify in Canada as "registered charities" if they were Canadian organizations. The credits may generally be claimed only against U.S.-source income, subject to Canadian percentage limitations. However, gifts to U.S. colleges or universities attended by the donor or a member of the donor's family are creditable against *Canadian-source income* (again, subject to Canadian percentage limitations).

Note: Canadians pay capital gains tax on unrealized gain when they contribute appreciated property to charity. However, since January 1, 1996, there is an offsetting deduction for the capital gains tax paid.

8.3.3 With rare exceptions, treaty provisions governing the deductibility of direct gifts to foreign nonprofits require that the taxing authorities of the *donor's* nation determine whether a charity organized in the other nation qualifies for public charity status under the laws of the donor's nation. The 1995 Protocol to the U.S.-Canada treaty[114] recognizes that Canadian law governing tax-exempt status is materially equivalent to U.S. law governing charities. Under the Protocol, the public charity status of a Canadian organization is recognized by the United States, without a separate determination by the IRS or oversight responsibility by a donor U.S. organization, and vice versa.[115] As a result, U.S. private foundations may make grants to Canadian "registered charities" free of the cumbersome expenditure responsibility that U.S. law usually imposes for such grants and without the duty to obtain affidavits or legal opinions regarding the donee's public charity status.

8.4 U.S.-MEXICO TREATY

The U.S.-Mexico tax treaty which came into effect on January 1, 1994[116] also contains unusually relaxed provisions allowing deductions for cross-border charitable gifts. Our shared border and new trade relationship with Mexico facilitated ratification of the new treaty. Congress found that an uncommonly strong U.S. national interest exists in promoting the development of Mexican charities.

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114 Revised Protocol Amending the 1980 Tax Convention with Canada, effective 1/1/95.

115 Id., at Article XXIX A, Paragraph 5(b).

116 Convention Between the Government of the United States of America and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income, effective 1/1/94.

8.4.1 The U.S.-Mexico treaty provisions are predicated on an emerging set of principles based on a common concept of charity and establishing rules for administering charities (including public disclosure of information) that are equivalent to the administration of charities in the U.S.

8.4.2 Article XXII of the treaty allows income tax deductions to U.S. citizens and residents for contributions to Mexican charities. The deductions are allowed only with respect to Mexican-source income and are subject to U.S. percentage limitations. Mexicans are allowed reciprocal deductions against U.S. source income (subject to Mexican percentage limitations) for contributions to U.S. charities.

8.4.3 The U.S.-Mexico treaty preceded the 1995 Protocol to the U.S.-Canada treaty in recognizing that (except for churches) the standards for income tax exemption under the laws of the two contracting states are essentially equivalent. Under this breakthrough provision, the responsibility for determining public charity status is consigned to the taxing authority of the nation in which the charity was organized. This permits U.S. private foundations to make grants to most Mexican public charities free of expenditure responsibility and without a separate determination of public charity status.

8.4.4 Our treaties with Mexico and Canada have not been perceived by Congress as opening the floodgates because of these countries' unique shared border relationships to the United States. Any subsequent treaty containing similar reciprocal recognition of charitable status will have to be based on a finding that equivalency of charitable principles and administration exists between the foreign country and the United States.

8.5 U.S.-ISRAEL TREATY

The U.S.-Israel Income Tax Treaty became effective January 1, 1995.[117] Before that, the 1975 convention and a significant 1980 protocol provided for mutual deductibility of charitable gifts by citizens of the U.S. and Israel to charities in the other nation. However, the 1980 protocol June 28, 2005 was never put into force and effect due to debates over whether the extension to Israel of the charitable contribution provisions of the U.S. treaties with Canada and Mexico could be justified, and not deemed favoritism, since the Canadian and Mexican provisions had been grounded in unique relationships arising from shared borders.

8.5.1 Article 15-A of the U.S.-Israel Tax Treaty permits U.S. citizens and residents to deduct contributions to Israeli charities against their *Israeli-source income* if the Israeli charity would have qualified for tax exemption under U.S. law had it been

[117] The U.S.-Israel Income Tax Treaty for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion, effective 1/1/95.

established here. The deduction is capped at a fixed percentage of Israeli-source adjusted gross income for individual donors and a different fixed percentage of Israeli-source taxable income for corporate donors.

8.5.2 Israelis are permitted a reciprocal deduction against *U.S.-source income* for contributions to U.S. charities that would qualify for tax exemption under Israeli law if organized there. The deduction is limited to 25% of U.S.-source taxable income.

8.6 MUTUAL RECOGNITION TREATIES

Some income tax treaties, such as the treaty between the U.S. and the Netherlands, contain mutual recognition provisions under which the U.S. recognizes organizations granted tax-exempt status under Dutch law as equivalent to U.S. charitable organizations and vice versa. Such a treaty provision *does not* allow a U.S. donor to make a direct contribution to that Dutch charity and claim a U.S. income tax charitable deduction. However, U.S. private foundations may make grants to Dutch charities that are the equivalent of U.S. public charities without exercising expenditure responsibility. Furthermore, a gift or bequest to such a Dutch entity by a U.S. donor or decedent will qualify for the U.S. gift or estate tax charitable deduction. [118]

8.7 THE FUTURE OF U.S. TREATY POLICY

As more foreign countries begin to replicate the U.S. charitable sector, more such treaty provisions may be acceptable to the United States. One commentator has noted three reasons why the United States is willing to support certain treaty provisions allowing deductible contributions to foreign charities even though there is no indication it would be willing to create those deductions through legislation. Professor Zack Mason of the University of Texas (San Antonio) has posited that treaty provisions are more palatable to the United States because (i) treaty approval is far less visible than tax legislation and therefore less likely to stir public interest or make headline news, (ii) approval of relatively minor tax treaty concessions may serve other political motives by improving our position in negotiating other treaty provisions of importance to the United States, and (iii) treaty provisions regarding charitable deductions benefit the United States because they are reciprocal, whereas legislation generally is not. This reciprocity makes it easier for U.S. charities to attract donations from residents of the other contracting nations and may thus have some positive economic benefits for U.S.

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[118] The Convention Between the United States of America and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income effective 12/18/92, as amended by Protocol effective 3/8/94, Article 7, Paragraph 2.e (replacing Article 26 of the 1992 Convention).

charities and, by extension, the U.S. government.[119] If Professor Zack is correct, such treaty provisions may become more common.

119 Mason, Zack D., "Foreign Charitable Contribution Deductions: A Shift in U.S. Tax Treaty Policy?", 7 Exempt Org. Tax Rev. 624 (April 1993).

9. INTERNATIONAL CHARITABLE GIFT PLANNING CASE STUDY HYPOTHETICALS

A. DESIGNING THE CHARITABLE REMAINDER TRUST

Jerry is 73 and his wife, Margaret is 70. Their son, Louis, is 48. Jerry and Louis are both U.S. citizens and residents. Margaret is a Canadian citizen resident in the United States. Jerry and Margaret ask you to review Jerry's charitable remainder unitrust, which was prepared as a favor by his friend, who is a litigation attorney. On review, you learn that the terms of the CRUT are as follows:

1. It is a standard pay 7% CRUT, to pay the unitrust amount to Jerry for life, then to Margaret for life, then to Louis for life. Jerry has reserved the right to revoke Margaret and/or Louis' interest during his life or at death. The CRUT was funded 2 years ago with $2 million of appreciated publicly-traded securities.

2. Jerry is the current trustee. After his death, the CRUT designates Margaret and then Louis as successor Trustee. Jerry has reserved the right to remove and/or replace trustees. Successor trustees may be designated currently or prospectively.

3. The named remainder beneficiary is the University of Toronto. Margaret attended the University of Toronto for 2 years before transferring to a U.S. college for her junior and senior years. The CRUT provides that the charitable remainder beneficiary must be an organization described in IRC §§170(c), 2055(a) and 2522(a). Jerry has reserved the right to change the charitable remainderman.

4. The CRUT gives the trustee the power to modify the trust solely for the purpose of qualifying it as a charitable remainder unitrust or qualified domestic trust.

   What problems do you see with the design of the CRUT? What do you advise Jerry to do now?

B. STRUCTURING AND DOCUMENTING PROCEDURES FOR FOREIGN GRANTMAKING BY U.S. PUBLIC CHARITIES

X, a U.S. organization which has previously received an IRS ruling that contributions to it are deductible under IRC section 170(c), asks you to obtain for it a ruling that its grants to Y, a foreign organization, will be deductible for income tax purposes. X's representative tells you that X has entered into an agreement with Y that X will conduct a fund-raising campaign in the U.S. on behalf of Y. In conducting the campaign, X plans to represent to prospective contributors that the funds raised will be transmitted to Y.

Assuming X has U.S. public charity status, what is your advice?

(See Rev. Rul. 63-252, Ex. 3)

C. DEDUCTIBILITY OF BEQUESTS TO BE USED ABROAD

Mr. Waters contacts you for assistance in preparing the federal estate tax return for the estate of Mr. DuGood, of which Mr. Waters is the executor. At your initial interview with Mr. Waters, you learn the following:

1. Mr. DuGood was a citizen and resident of the United States. His parents, however, were residents of Zurich, Switzerland, and Mr. DuGood had close ties to Zurich. Mr. DuGood's entire estate consists of U.S. property.

2. Mr. DuGood's Will bequeathed the residue of his estate to the Mayor of Zurich, "to be used and expended for the benefit of the city of Zurich."

3. The Zurich City Council has been notified of the bequest and has entered into an agreement with the Estate that it will use the funds to build, operate and maintain a home for the city's aged inhabitants.

4. A probate proceeding with respect to the Estate has been opened. The federal estate tax return is due in 3 months.

What advice do you give Mr. Waters regarding the availability of an estate tax charitable deduction for Mr. DuGood's residuary bequest? What issues will you research so that you may determine what strategy to pursue? Would you recommend any actions with respect to the probate proceeding?

(See Continental Illinois Bank and Trust Company, 403 F.2d 721 [1968])

D. PROCEDURES FOR GRANTS ABROAD BY U.S. PRIVATE FOUNDATIONS

You are asked to advise the board of trustees of Fund X, a U.S. private foundation organized in trust form, what procedures it must adopt in order to ensure that contributions to it will be deductible under IRC section 170(c).

1. The president of the board has told you that Fund X was organized for the relief of poor, distressed and displaced persons in Africa. Although the Fund has procedures for designating other grantees, for the present it has selected and distributes its funds directly to Organization Y. Y is an organization comprised of independent sovereign African nations, the purpose of which is to coordinate and harmonize the general policies of the member nations concerning matters of health, sanitation and nutrition.

2. Fund X is incapable of listing in advance the names of the ultimate recipients of the funds it will turn over to Y. It is understood and agreed between X and Y, however, that the funds will be used only for "humanitarian purposes," such as furnishing food, clothing, shelter, medical supplies and services for distressed persons. Pursuant to this understanding, Y will distribute funds to relief organizations approved and selected by it, and perhaps in some cases to unorganized groups of refugees and other distressed persons.

3. X requires that Y and all ultimate recipient organizations submit periodic accountings to X.

What specific recommendations would you make to the board of trustees of Fund X regarding changes in its grantmaking procedures?

The president of X plans to solicit donations from U.S. corporations. What do you advise her regarding the deductibility of corporate contributions to X?

(See GCM 35319 [4/27/93])

E. INTERNATIONAL CHARITABLE GIVING

FACTS: Mr. Rojas is a citizen of Spain. He is the CEO of an import-export business headquartered in Spain. Mr. Rojas spends 9 months of each year in Spain, and 3 months in the U. S., working out of the company's New York subsidiary. His wife is a citizen of Spain who lives in New York and visits Spain for 1 month each summer. Their son, Miguel Rojas, was born in the U. S. and lives with his mother while attending school here. Mrs. Rojas and Miguel have no current intention of changing their residence.

1. Mr. Rojas makes a lifetime charitable gift of U. S. investment real property to the American Red Cross, for its general purposes. The American Red Cross sells the property and uses the net proceeds to provide famine relief in Ethiopia.

   a. Will Mr. Rojas be allowed a U. S. income tax deduction for his gift? A gift tax deduction?

   b. What if the gift to the American Red Cross were of stock of a U. S. corporation?

2. Mr. Rojas creates a testamentary charitable remainder unitrust to benefit Mrs. Rojas for life and pass to Miguel's school, Columbia University, on her death.

   a. Will he be allowed a U. S. estate tax charitable deduction? A marital deduction?

   b. What if Mr. Rojas' Spanish alma mater were the remainderman?

   c. What are the U. S. estate tax consequences during Mrs. Rojas' overlife if the trust is a net income unitrust? A standard unitrust?

United States Internal Revenue Service (IRS) Circular 230 disclosure:

To ensure compliance with requirements imposed by the IRS, we inform you that, unless and to the extent we otherwise state, any U.S. federal tax advice contained in this outline (including any attachments) is not intended or written to be used, and cannot be used, by any taxpayer for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

(SAMPLE REV. PROC. 92-94 AFFIDAVIT)

Affidavit for
Equivalency Determination

FOREIGN PUBLIC CHARITY EQUIVALENCE
AFFIDAVIT OF OFFICER
(All information provided must be in English)

The undersigned, to assist grant making foundations in the United States of America to determine whether ____
(name of grantee organization)
(the "Grantee") is the equivalent of a public charity described in section 509(a)(1), (2), or (3) of the United States Internal Revenue Code, makes the following statement:

1. **Office.** I am the ____________________________ of the Grantee.
[official title]

2. **Formation and purposes.** The Grantee was created in _____ by ______ [year] [identify __________________________ statute, charter, or other document] and is operated under the laws of __________________ [country] exclusively for the following purposes [check applicable boxes]:

[ ] charitable
[ ] religious
[ ] scientific
[ ] literary
[ ] educational
[ ] fostering national or international amateur sports competition
[ ] prevention of cruelty to children or animals

3. **Programs and activities.** The Grantee's programs and activities have included and will include the following:

____
[describe past, current, and future activities; add pages if necessary]

____

____

____

4. **Governing documents**. We have attached copies of the charter, bylaws, and other documents under which the Grantee is governed.

5. **No improper private benefit.** Under the applicable laws and customs or under the Grantee's governing instruments, none of the Grantee's income or assets may be distributed to, or applied for the benefit of, a private person or noncharitable organization other than (a) as part of the conduct of the Grantee's charitable activities, or (b) as payment of reasonable compensation for services rendered, or (c) as payment representing the fair market value of property which the Grantee has purchased.

6. **No proprietary interest in Grantee.** The Grantee has no shareholders or members who have a proprietary interest in its income or assets.

7. **Distribution of assets on dissolution.** Under the applicable laws and customs, or under the Grantee's governing instruments, all of its assets will be distributed upon its dissolution or liquidation to another not-for-profit organization for charitable, religious, scientific, literary, or educational purposes, or to a government instrumentality. We have attached a copy of the relevant statutory law or provisions in the Grantee's governing instruments controlling the distribution of the Grantee's assets on dissolution or liquidation.

8. **Limits on activities.** Under the laws and customs applicable to the Grantee, or under the Grantee's governing instruments, the Grantee is not permitted, other than as an insubstantial part of its activities, to:

(a) engage in activities that are not for religious, charitable, scientific, literary, or educational purposes; or

(b) attempt to influence legislation, by propaganda or otherwise.

9. **No candidate campaign activity.** The laws and customs applicable to the Grantee do not permit it to participate or intervene, directly or indirectly, in any political campaign on behalf of, or in opposition to, any candidate for public office.

10. **Control by other organizations.** The Grantee is [choose one]:

[ ] not controlled by, or operated in connection with, any other organization.

[ ] controlled by or operated in connection with another organization or organizations, as follows:

[describe] ____

____

____

11. **Qualification as publicly supported organization.** The Grantee is [check one of the following]:

[ ] a school (that is, an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on and that has adopted and operates pursuant to a racially nondiscriminatory policy as to students, and we have completed IRS Form 5578).

[ ] a hospital (that is, an organization whose principal purpose or function is the providing of medical or hospital care).

[ ] a church (that is, a church, synagogue, or mosque).

[ ] none of the above, but it receives at least 33-1/3% of its funding from the general public.

12. **Financial Support.** A Schedule of Financial Support for the five most recently completed taxable years is attached.

13. **Authorization.** The ______________________________ of the Grantee
[governing body; e.g., board of directors]
has authorized me to **make** this Declaration and affirms its contents.

14. **Binding representations.** The representations made in this Declaration are binding on the Grantee.

I declare that the foregoing is true and correct of my own knowledge.

DATE: ____________________ ______________________________________
[signature of declarant]

APPENDIX B

International Grants by U.S. Private Foundations

	Grantee's Status	May Pvt. Fdn. Fund?	Equivalency Determination Required?	Expenditure Responsibility Required?	Does Grant Satisfy Minimum Payout Rule?
1	U.S. §501(c)(3) operating overseas	Yes	No, if grant in furtherance of grantee's purposes.	No, if grantee is public charity.	Yes
2	"Friends of" organization	Yes	No	No, if grantee is public charity.	Yes
3	Foreign government unit without §501(c)(3) status	Yes	No, but grant must be limited to charitable, not public, purposes.	No	Yes
4	Foreign entity with §501(c)(3) IRS determination letter	Yes	No	No, if grantee is public charity.	Yes
5	Foreign equivalent of §501(c)(3) entity that is a public charity	Yes	Yes	No, if grantee can qualify as public charity.	Yes
6	Foreign equivalent of §501(c)(3) organization that is a private foundation	Yes	Yes, unless clearly not public charity equivalent.	Yes	Yes, if out-of-corpus rule satisfied.
7	Other foreign organization that cannot qualify as §501(c)(3) equivalent	Yes	No. Not possible.	Yes, and grant funds must be segregated.	Yes

APPENDIX C

COMPARATIVE CHART

U.S. ESTATE AND GIFT TAXATION
U.S. CITIZENS AND RESIDENTS VS. NONRESIDENT ALIENS

	U.S. Citizens & Residents[1]	**Nonresident Aliens**
ESTATE TAX		
Assets Subject to U.S. Estate Tax	Worldwide assets	U.S. situs assets only[2]
Credit Against Tax	$1,772,800 in 2013	$13,000[3]
Exemption Amount	$5.25 million in 2013	$60,000
Estate Tax Rates	40% in 2013	Same[4]
Marital Deduction	QTIP, general power of appointment marital trust, estate trust or outright gift; must be qualified domestic trust if noncitizen spouse	QTIP, general power of appointment trust or estate trust; must also meet requirements for "qualified domestic trust"[5]
Credits & Deductions Against U.S. Estate Tax	Expenses, losses, debts, claims, taxes, charitable & marital	Same, but only for expenses, losses, debts, claims & taxes with respect to U.S. situs assets, incurred in the U.S.[6]; also, QDOT requirement for marital gift

1 For definition of U.S. "resident," see Treas. Reg. §20.0-(b)(1) [estate tax] and §25.2501(1)(b) [gift tax]

2 IRC §2103

3 IRC §2102(c)(1)

4 RC §2101(b)

5 IRC §§2056(d)(1) and 2056A

6 IRC §2106(a)(1)

	U.S. Citizens & Residents[1]	Nonresident Aliens
Double Tax Avoidance	(i) Credit for foreign death taxes[7] (ii) Deduction for foreign death taxes as claim[8] (iii) Deduction for foreign death taxes on foreign situs property left to charity[9]	Treaty relief
GIFT TAX		
Gifts Subject to U.S. Gift Tax	All gifts other than annual exclusion, education/medical and marital or charitable	Gifts of tangible personal property in U.S. or of U.S. real property. Gifts of intangibles not subject to U.S. tax[10]
Lifetime Exemption	$5.25 million	None
Gift Tax Rates	40% in 2013	Same
Annual Exclusions	$14,000 per donee per year in 2013	Same
Marital Deduction	Unlimited for gifts to citizen spouse. $100,000 per year for gifts (with COLA adjustment) to noncitizen spouse[11] - $143,000 in 2013	Same
Gift Splitting	Yes	No
Foreign Gift Tax Credit	No, but relief under some treaties	No, but relief under some treaties

7 IRC §2014.

8 IRC §2053(a)(3); Treas. Reg. 20.2053(6)(f); Rev. Rul. 82-82, 1982-1 C.B. 127 (for foreign death tax not so considered for IRC §2014 purposes).

9 IRC §2053(d)(1)(b); Treas. Reg. §20.2053-10(a).

10 IRC §§2511(a), 2501(a)(2).

11 IRC §2523(i).

APPENDIX D

COMPARATIVE CHART

U.S. TAXATION OF INTERNATIONAL CHARITABLE GIFTS

	U.S. Citizens & Residents	Nonresident Aliens
INCOME TAX		
Gift to Foreign Charity	No deduction for direct gift absent treaty provision[1]	Same
Earmarked Gift to U.S. Charity with Direct Operations Abroad	Deduction allowed	Same
Gift to U.S. Charity Regranted for Use Abroad	No deduction if funds earmarked for foreign use[2]; deduction allowed for unrestricted gifts used abroad[3]	Same
Gift by NRA to U.S. Charity	N/A	Deduction allowed only for gifts of income "effectively connected" with conduct of U.S. trade or business[4]

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1 IRC §170(c)(2)(A).

2 IRC §170(c)(2).

3 Treas. Reg. §1.170A-8(a)(1).

4 Treas. Reg. §1.873-1(a)(1). NRAs are subject to U.S. income tax only on "effectively connected income" and fixed or determinable annual or periodic income (FDADPI).

	U.S. Citizens & Residents	**Nonresident Aliens**
ESTATE TAX		
Testamentary Transfers to Foreign Charities	100% deduction[5]; foreign death tax credit for foreign death taxes on charitable transfer[6]; deduction of other foreign taxes as claims.[7] Estate may claim more beneficial of Code or treaty foreign death tax credit.[8]	100% deduction if bequest to: (i) U.S. corporate charity, (ii) charitable trust for use within U.S. (iii) fraternal society for use within U.S., OR (iv) veterans' organization organized in U.S. No deduction for bequest to foreign charity absent treaty provision.

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5 IRC §2055.

6 IRC §2014.

7 IRC §2053(d)(1).

8 Treas. Reg. §20.2014-4(a)(1).

	U.S. Citizens & Residents	Nonresident Aliens
GIFT TAX		
Gifts to Foreign Charities	100% deduction[9]	No U.S. gift tax deduction[10]
Gifts to U.S. Charities	100% deduction[9]	(a) U.S. gift tax imposed only on gifts of U.S. situs tangible property & real property,[11] so gift tax not an issue as to intangibles. (b) Charitable deduction for gifts of U.S. tangibles or real property allowed if: (i) to U.S. corporate charity, (ii) to charitable trust for use within U.S., (iii) to fraternal society for use within U.S., OR (iv) to veterans' organization organized in U.S. [10]

9 IRC §2522(a).

10 IRC §2522(b).

11 IRC §2511(a).

APPENDIX E

SUMMARY OF U.S. RESIDENCE TESTS

Income Tax

a. Green card

or

b. Objective Substantial Presence Test:

– 183 days in current calendar year

or

– 31-182 days in current calendar year where total days in current and immediately preceding two years (1/3 days in preceding year and 1/6 days in second preceding year) is 183 or more

or

c. Subjective Substantial Presence Exception where objective test met but NRA has:

– foreign tax home

and

– closer connection to that foreign country

Transfer Taxes

Presence in the U.S. with the intent to remain indefinitely (domicile)

APPENDIX F

SUMMARY

U.S. INCOME TAXATION OF NONRESIDENT ALIENS

Unlike U. S. citizens and residents, NRAs are subject to U. S. income tax only on fixed or determinable annual or periodical income derived from U. S. sources ("FDAPI") and other income effectively connected with the conduct of a trade or business in the U.S. ("ECI").

FDAPI **Flat 30% Tax**[1]	**ECI** **Graduated Tax**
Interest	U.S. source employees' salaries/wages
Dividends	Gain on sale of U.S. real property (USRPI)
Rents	
Independent contractors' compensation	U.S. source income effectively connected with the conduct of a U.S. trade or business
Premiums	
Royalties	Foreign source income attributable to U.S. office/fixed place of business[2]
Annuities (including taxable portion of charitable gift annuity payments)	

[1] Generally, the U.S. allows no income tax credit for foreign taxes on FDAPI and ECI.

[2] When ECI is foreign source, the U.S. allows a foreign tax credit.

APPENDIX G

ANTI-TERRORIST FINANCING LEGISLATION & GUIDELINES

Checking the Lists:

- U.S. Department of the Treasury's Office of Foreign Assets Control Specially Designated Nationals List (OFAC SDN) http://www.treas.gov/offices/enforcement/ofac/sdn/index/html
- U.S. Department of State Terrorist Exclusion List (TEL) http://www.state.gov/s/ct/rls/fs/2004/32678.html
- Executive Order 13224 (original list) http://www.fas.org/irp/offdocs/eo/eo-13224.html
- Executive Order 13224 (amended list) http://www.treas.gov/offices/enforcement/ofac/sanctions/terrorism.html
- United Nations Security Council Resolution 1267 list http://www.un.org/Docs/sc/committees/1267/1267ListEng.html
- European Union EU Regulation 2580 list http://europa.eu.int/eur-lex/pri/en/oj/dat/2003/1-340/1_34020031224en00630064.pdf

Further Reading on Anti-Terrorist Financing Rules:

1. "Handbook on Counter-Terrorism Measures: What U.S. Nonprofits and Grantmakers Need to Know," Independent Sector, Council on Foundations, and Day, Berry & Howard Foundation(3/15/04) available on the Council on Foundations website at www.cof.org.

2. I.R.S. Announcement 2003-29, 2003-20 I.R.B. 928, regarding International Grant-Making and International Activities by Domestic 501(c)(3) organizations.

3. "Principles of International Charity," developed by the Treasury Guidelines Working Groups of Charitable Sector Organizations and Advisors, a working group of over 40 charitable sector organizations under the leadership of the Council on Foundations (3/05). Available on the Council on Foundations website, www.cof.org, or at the Planned Giving Design Center website (posted on PGDC on 4/29/05).

APPENDIX H

INTERNATIONAL GRANTMAKING UPDATE

An Update on U.S. Foundation Trends

December 2012

International Grantmaking Update

A Snapshot of U.S. Foundation Trends

International Grantmaking Update: A Snapshot of U.S. Foundation Trends provides a brief update on key trends. The study includes an analysis of patterns of giving in 2010 and changes in funding priorities between 2008 and 2010. (For more information on international giving by foundations based outside of the United States, see "Tracking Grantmakers Worldwide.")

INTERNATIONAL GRANTMAKING TRENDS THROUGH 2010

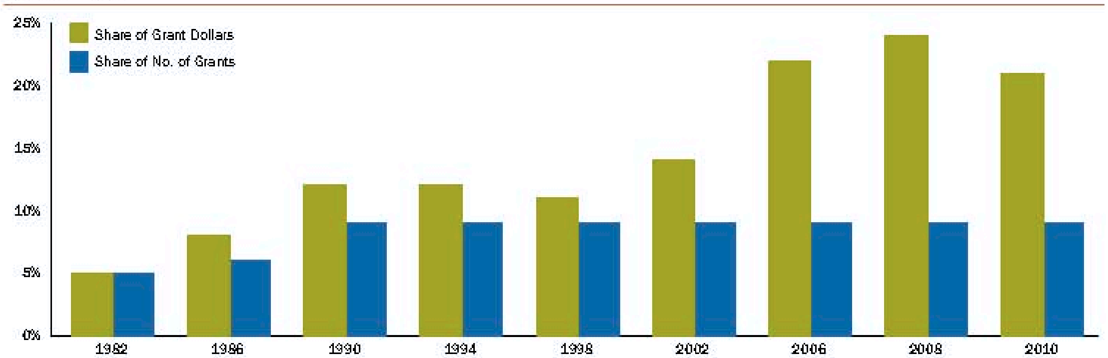
The following analysis examines funding patterns based on all of the grants of $10,000 or more reported by a sample of 1,330 larger U.S. foundations in 2010. These foundations accounted for roughly half of all foundation giving in 2010 and well over four-fifths of total estimated international giving. The analyses of changes in funding between 2008 and 2010 are based on a subset of these grants awarded by a matched group of 424 foundations. In addition, grant amounts reported reflect the full authorized value of the grants in the year they were made whenever possible, regardless of whether they were paid out in that year or over several years. (See "Sampling Base" for details.)

- *International grant dollars declined faster than overall funding between 2008 and 2010.*

International funding by the full set of over 1,300 foundations totaled $4.3 billion in 2010, down from $6.3 billion in 2008. Figure 1 shows that international support declined from 24.4 percent to 21 percent of overall giving. (Excluding the Bill & Melinda Gates Foundation, these shares would be 15.5 percent and 14.1 percent, respectively.) By share of number of grants, however, international giving remained mostly unchanged at 9.1 percent.

Among the matched set of funders, international giving dropped 40 percent during this two-year period.

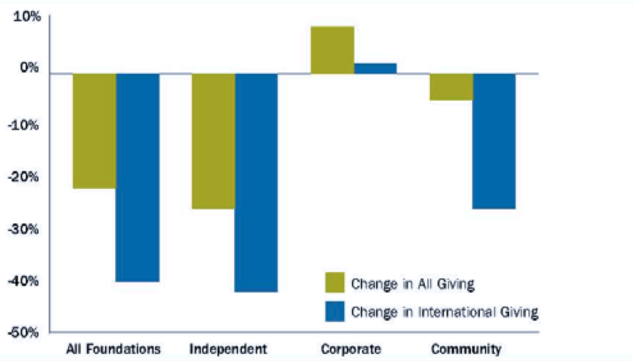
FIGURE 1. International grant dollars as a share of overall giving declined between 2008 and 2010, while the share of number of grants has held steady



SOURCE: The Foundation Center, *International Grantmaking Update, 2012*. Based on grants awarded by a sample of the largest U.S. foundations.

© 2012 The Foundation Center—*International Grantmaking Update*

FIGURE 2. **International giving decreased faster than overall giving for independent and community foundations between 2008 and 2010**



SOURCE: The Foundation Center, *International Grantmaking Update*, 2012. Change in unadjusted grant dollars. Based on all grants of $10,000 or more awarded by a matched set of 424 grantmakers in 2008 and 2010.

By comparison, overall grantmaking among these funders decreased by 22 percent. A reduction in the number of exceptionally large, often multi-year commitments account for more than half of this reduction. The combined value of exceptionally large grants of $10 million and more in particular saw a sharp decline in 2010 (55.3 percent), accounting for a significant portion of the fall. Excluding the Bill & Melinda Gates and William and Flora Hewlett foundations, international giving decreased by 25 percent, while overall grantmaking would have decreased by 15 percent.

- ***Among independent and community foundations, international funding declined faster than overall giving.***

Independent foundations reported the steepest drop in international giving (down 42 percent) among the matched set of funders (Figure 2). Among the full set of sampled funders, independent foundations accounted for nearly 88 percent of the 2010 international grant dollars awarded and nearly 64 percent of the number of grants.

Corporate foundations represented 7.9 percent of 2010 international grant dollars and 19.7 percent of grants. The Coca-Cola Foundation (NY), which supports programs designed to promote water stewardship, healthy and active lifestyles, community recycling, and education, ranked as the top international funder among corporate foundations in 2010, awarding $27.9 million. Among the types of foundations included in the analysis, only corporate foundations reported increases in international funding between 2008 and 2010 (up 2 percent). Overall international funding by corporate foundations increased by 9 percent during this period.

Community foundations provided just 2.3 percent of international grant dollars—although they awarded a significantly larger share of grants (13.7 percent). The Silicon Valley Community Foundation (CA) ranked

Sampling Base

The Foundation Center's circa 2010 grants database includes all grants of $10,000 or more awarded by 1,330 of the largest U.S. foundations—including at least 800 of the 1,000 largest foundations based on total giving and the 15 largest funders in nearly every state—and reported to the Center between October 2010 and September 2011. Grants were authorized or paid primarily in 2010 or 2009.

The *International Grantmaking Update* also includes a matched set analysis of year-to-year changes in giving by sampled grantmakers. Over time, the sample size has changed, which could distort year-to-year fluctuations in grant dollars and grants targeting specific activities or populations. To account for these potential distortions, changes in giving are analyzed only for a matched set of funders included in both the 2008 and 2010 samples.

GRANTS PAID VS. GRANTS AWARDED

The *International Grantmaking Update* reports grant information based primarily on the total amount authorized, whether it is paid during a single year or in several installments over a period of years. If the full amount authorized is not available, the amount paid during the year is shown.

The drawback of this measure is that if a foundation pays out a substantial multi-year commitment made at an earlier point in time, it will overstate the commitments being made by that foundation for that given year. Conversely, it does not capture the full extent of payments being made for other years. For example, Hall Family Foundation's grant payments in 2010 totaled under $29 million, while the foundation awarded just over $85 million in new grant commitments that year. Thus, depending on what time period is being examined, a foundation's grant commitments may appear to overcount—or undercount—its current payments.

as the largest international funder among this group, with giving of just over $33 million. The foundation facilitates charitable giving by individual and corporate donors in and around Santa Clara Valley and it has solidified its commitment to international grantmaking by launching the Donor Circle for Africa in 2012.

Gates Foundation accounted for roughly two out of five international grant dollars in the sample.

Since 2002, the Bill & Melinda Gates Foundation has ranked as the nation's largest international funder—and the largest grantmaker overall (Table 1). In the full 2010 sample, the Gates Foundation provided 38.7 percent of international grant dollars. By comparison, the second-ranked Ford Foundation (NY) represented 5 percent of the international total.

Between 2008 and 2010 the Gates Foundation decreased both its overall funding and the proportion of its grant dollars awarded internationally. Compared to the other grantmakers as a whole, the foundation reduced international grantmaking by roughly the same. International grantmaking by the Gates Foundation decreased by 39.9 percent, while the matched set excluding Gates reported a 40.4 percent decrease.

TABLE 1. Top 15 Foundations by International Giving, 2010

Foundation	Foundation Type[1]	Foundation State	Amount of Intl. Grants	No. of Intl. Grants
1. Bill & Melinda Gates Foundation	IN	WA	$1,646,624,977	553
2. Ford Foundation	IN	NY	198,452,178	821
3. Walton Family Foundation	IN	AR	129,977,488	19
4. William and Flora Hewlett Foundation	IN	CA	106,189,687	155
5. Susan Thompson Buffett Foundation	IN	NE	97,161,526	45
6. David and Lucile Packard Foundation	IN	CA	94,265,821	174
7. John D. and Catherine T. MacArthur Foundation	IN	IL	77,952,559	231
8. Rockefeller Foundation	IN	NY	75,096,381	213
9. Bloomberg Family Foundation	IN	NY	74,451,041	8
10. Howard G. Buffett Foundation	IN	IL	62,832,857	69
11. Gordon and Betty Moore Foundation	IN	CA	46,225,737	91
12. Andrew W. Mellon Foundation	IN	NY	41,519,186	129
13. McKnight Foundation	IN	MN	40,993,000	100
14. Carnegie Corporation of New York	IN	NY	39,958,100	93
15. Silicon Valley Community Foundation	CM	CA	33,245,421	406

SOURCE: The Foundation Center, *International Grantmaking Update*, 2012. Based on a sample of grants of $10,000 or more from 1,330 larger foundations.
[1]IN=Independent Foundation; CM=Community Foundation.

More than half of sampled foundations provided international support.

In the full 2010 sample, 60 percent of funders (799 out of 1,330) awarded at least one international grant. This share was up slightly from the 57 percent share (848 out of 1,490) tracked in 2008. Newer foundations—those established since 1995 (a year after the Gates Foundation was created)—have helped to raise the level of international giving. In 2010, these 192 younger foundations accounted for 14 percent of total international giving. Of these newer funders, 69 gave at least $1 million for international programs. The largest new funder was the Bloomberg Family Foundation, formed in 2006, which focuses on public health and medical research. Other examples of relatively new funders include DC-based New Mighty Foundation

International Funding by Public Charities

The grants set used for this analysis of international giving trends includes only private and community foundations. However, the Foundation Center also collects information on grantmaking public charities, sometimes referred to as "public foundations." The Center's grantmaker database currently includes 13,110 public charities, of which 1,371 (10.5 percent) fund internationally. These grantmakers support a wide range of causes. Several of the largest funders by total giving reported, such as Global Health Solutions, Food for the Poor, AmeriCares, and World Vision, provide healthcare and/or emergency relief. Other areas of support include the environment (e.g., ClimateWorks Foundations); children (e.g., Compassion International, Plan International); education (e.g., Brother's Brother Foundation); and specific countries or areas of the world (e.g., United Israel Appeal, American Nicaraguan Foundation). In addition to distributing funds raised from the broad public, grantmaking public charities frequently function as regranting agencies through which private foundations can channel their cross-border giving.

(2007), which focuses on education; and the Sea Change Foundation (2006), which supports giving to address the serious threats posed by global warming.

Overseas funding accounted for a smaller share of international grant dollars.

The country's foundations have historically provided a larger share of their international giving to U.S.-based programs, reflecting a tendency among newer international funders to rely more heavily on U.S.-based agencies, as well as the more difficult environment for funding overseas—especially post-9/11. Overseas giving in 2010 represented 32 percent of international grants and 36 percent of international grant dollars.

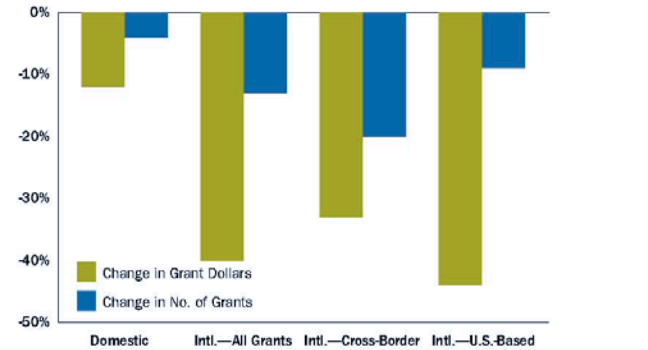
Both cross-border grants and grants to U.S.-based international programs saw declines between 2008 and 2010, 33 percent and 44 percent respectively (Figure 3).

Overseas giving primarily benefited global programs, Asia, and Africa.

About one-third of international grantmakers in the 2010 sample made grants to overseas recipients. This group included both large funders, such as the Rockefeller (NY) and William and Flora Hewlett (CA) foundations, and smaller funders, such as the Cyrus Tang Foundation (NV) and Naomi and Nehemiah Cohen Foundation (MD).

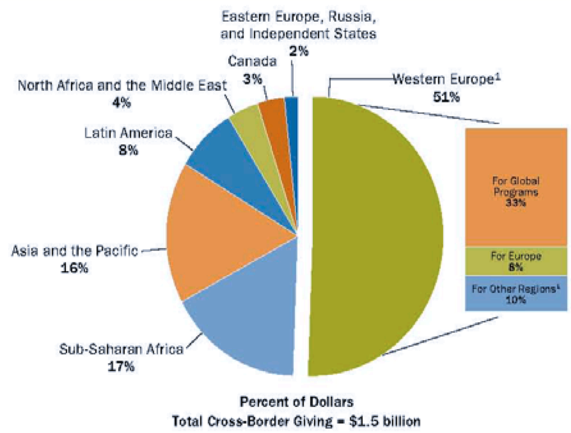
Of the more than $1.5 billion in cross-border giving reported in 2010, global programs coordinated by Western European organizations—e.g., the Switzerland-based World Health Organization—ranked first with almost 33 percent of these dollars (Figure 4). An additional 9.7 percent supported the work of Western European organizations in specific regions of the world outside of Western Europe. Among grant dollars going directly to the regions of benefit, Sub-Saharan Africa (16.5 percent) and Asia and the Pacific (16.4 percent) accounted for the largest shares.

FIGURE 3. **In grant dollars, both U.S.-based and cross-border international giving decreased substantially between 2008 and 2010.**



SOURCE: The Foundation Center, *International Grantmaking Update*, 2012. Based on all grants of $10,000 or more awarded by a matched set of 424 grantmakers in 2008 and 2010.

FIGURE 4. **Global Programs, Africa, and Asia, received the largest shares of cross-border giving in 2010**



SOURCE: The Foundation Center, *International Grantmaking Update*, 2012. Based on all grants of $10,000 or more awarded by a sample of 1,330 foundations in 2010. Grants to overseas recipients may be for programs conducted in other countries or regions.
[1]The majority of grants awarded to Western Europe were for activities in the regions of Sub-Saharan Africa, Asia and the Pacific, and Latin America.

Compared to 2008, the shares of international grants from sampled foundations to Sub-Saharan Africa and global programs managed by Western Europe-based organizations increased. In contrast, shares declined for Asia and the Pacific, Canada, and Eastern Europe.

Health Captured the Largest Share of International Support.

Consistent with international funding priorities tracked since 2001, health benefited from by far the largest share of 2010 grant dollars awarded by sampled foundations. Close to 41 percent of international support funded health—primarily medical research and public health—and this share was up from close to 39 percent in 2008 (Figure 5).

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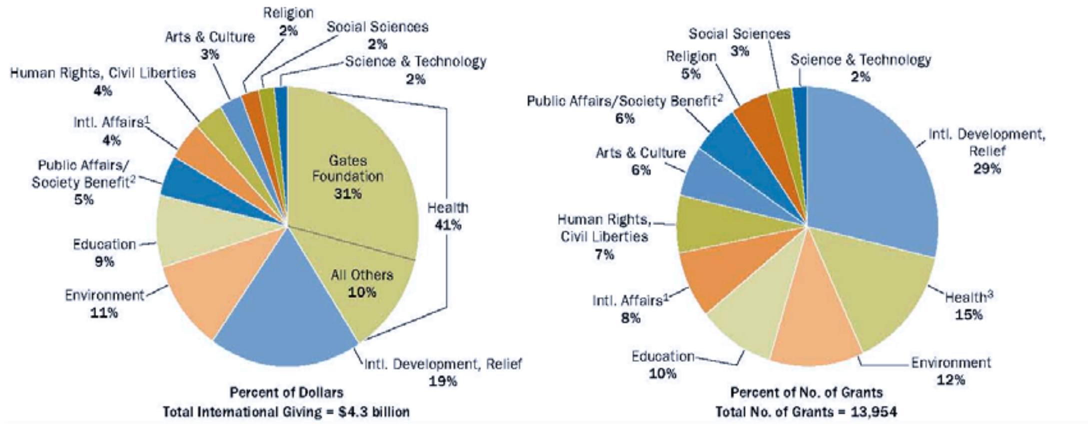
The Bill & Melinda Gates Foundation dominated foundation support for health, providing just over three-quarters of grant dollars among sampled foundations. The Gates Foundation also accounted for roughly a third of 2010 funding in the second-ranked area of international development and relief.

The environment and animals ranked third among international funding priorities in both 2008 and 2010, although its share of international grant dollars dropped in the latest year from 16.8 percent to 10.5 percent. International grant dollars for the environment was extraordinarily high in 2008 in part because of an exceptionally large multi-year grant awarded by the William and Flora Hewlett Foundation to the ClimateWorks Foundation.

Unusually large grants can markedly influence overall giving patterns, while shares of number of grants awarded tend to be more consistent. For example, international development and relief benefited from the largest share of international grants awarded in 2008 (28.9 percent), and this share was close to what it was in 2010 (26.1 percent). Health and the environment combined accounted for another 26.5 percent of grants in the latest year. All of the remaining fields received less than 10 percent of the number of international grants reported in 2010.

FIGURE 5. **Health far surpassed all fields by share of international giving in 2010**



SOURCE: The Foundation Center, *International Grantmaking Update*, 2012. Based on all grants of $10,000 or more awarded by a sample of 1,330 foundations in 2010.
[1]Includes grants for peace and security, foreign policy, promoting international understanding, and international affairs research/policy.
[2]Includes grants for public affairs, philanthropy, and general grants to promote civil society. Civil society grants are also found in other categories, such as human rights and international development.
[3]The Gates Foundation accounted for 2.8 percent of the total number of grants for health.

International Funding for Indigenous People

Over 10 years ago, the United Nations launched the International Decade of the World's Indigenous People to celebrate their contributions and address their needs. To what extent are private foundations supporting programs that benefit this population? In a search of its grants database for 2010, the Foundation Center identified 313 international grants totaling $41 million that targeted indigenous people. The largest share of this funding targeted the environment and animals (38.2 percent), followed by public affairs/society benefit (19.9 percent), international affairs, development, peace, and human rights (15.2 percent), education (7.5 percent), human services (5.9 percent), health (4.2 percent), arts and culture (3.8 percent), social sciences (3.8 percent), and science and technology (1.5 percent).

The Ford Foundation accounted for just over half (51.2 percent) of giving benefiting indigenous people in 2010. Ford's grants funded a range of activities, including support for training and technical assistance to help local civil society organizations in the Brazilian Amazon better use legal instruments in defense of identity and land rights. Other grantmakers that provided at least $1 million in grants benefiting indigenous peoples in the latest grants set included the Christensen Fund, Gordon and Betty Moore, John D. and Catherine T. MacArthur, ExxonMobil, and Charles Stewart Mott foundations.

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Tracking Grantmakers Worldwide

While this report focuses on grantmaking by U.S.-based foundations, philanthropic institutions exist and have been expanding in most parts of the globe. In early 2013 "Fondos a la Vista" (which roughly translates to "Funds at a Glance")—a database of Mexican grantmakers and nonprofit organizations created in partnership with Alternativas y Capacidades, ITAM, and the US-Mexico Border Philanthropy Partnership—is set to launch. It joins the resources of the China Foundation Center (estab. 2010), Japan Foundation Center (estab. 1985), European Foundation Centre (estab. 1989), and numerous other grantmaker and regional associations in serving the needs of funders around the world.

Similar to the vast majority of U.S. foundations—which fund in limited geographic areas—most grantmakers in other countries concentrate their activities within their nations' borders. U.S. and other funders are also similar in that they generally do not collaborate with one another. Yet among leading funders in all parts of the world, there is tremendous interest in understanding the priorities of other grantmakers and, where appropriate, finding ways to pool knowledge and resources for greater impact.

No other country requires the detailed and publicly available annual reporting mandated for U.S. foundations. However, a number of organizations—including the Foundation Center—are working to expand the information available on institutional philanthropy worldwide. For example, NGOs in more than a dozen regions or countries publish grantmaker directories (see foundationcenter.org/getstarted/topical/international); Worldwide Initiatives for Grantmaker Support (WINGS) provides a network of nearly 150 membership associations and support organizations serving grantmakers (wingsweb.org); and the Foundation Center displays grantmaking by both U.S. and overseas funders in Philanthropy In/Sight, its online, interactive data visualization tool (philanthropyinsight.org). The availability of these types of data is certain to expand markedly over the coming decade.

FOUNDATION CENTER
Knowledge to build on.
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ABOUT THE FOUNDATION CENTER

Established in 1956 and today supported by close to 550 foundations, the Foundation Center is the leading source of information about philanthropy worldwide. Through data, analysis, and training, it connects people who want to change the world to the resources they need to succeed. The Center maintains the most comprehensive database on U.S. and, increasingly, global grantmakers and their grants—a robust, accessible knowledge bank for the sector. It also operates research, education, and training programs designed to advance knowledge of philanthropy at every level. Thousands of people visit the Center's web site each day and are served in its five regional library/learning centers and its network of 450 funding information centers located in public libraries, community foundations, and educational institutions nationwide and beyond. For more information, please visit foundationcenter.org or call (212) 620-4230.

For more information contact Reina Mukai at (212) 807-2485 or rkm@foundationcenter.org. "International Grantmaking Update" is available at foundationcenter.org.

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APPENDIX I

REVENUE RULING 63-252
AND REVENUE RULING 66-79

Internal Revenue Service
Revenue Ruling

TaxLinks.com

Rev. Rul. 63-252

1963-2 C.B. 101

Sec. 170

Caution: Amplified by Rev. Rul. 66-79

IRS Headnote

Deductibility of contributions by individuals to a charity organized in the United States which thereafter transmits some or all of its funds to a foreign charitable organization.

Full Text

Rev. Rul. 63-252

Advice has been requested as to the deductibility, under section 170 of the Internal Revenue Code of 1954, of contributions by individuals to a charity organized in the United States which thereafter transmits some or all of its funds to foreign charitable organization.

Section 170 of the Code provides, in material part, as follows:

(a) ALLOWANCE OF DEDUCTION.-

(1) GENERAL RULE.-There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary or his delegate.

*

(c) CHARITABLE CONTRIBUTION DEFINED.-For purposes of this section, the term ‘charitable contribution’ means a contribution or gift to or for the use of-

*

(2) A corporation, trust, or community chest, fund, or foundation-

(A) created or organized in the United States or in any possession thereof, or under the law of the United States, any State or Territory, the District of Columbia, or any possession of the United States;

(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals;

(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and

(D) no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation. A contribution or gift by a corporation to a trust, chest, fund, or foundation shall be deductible by reason of this paragraph only if it is to be used within the United States or any of its possessions exclusively for purposes specified in subparagraph (B).

In determining whether contributions to or for the use of a particular corporation, trust, community chest, fund, or foundation are deductible, it must first be determined that the recipient organization was validly created or organized in the United States, a state or territory, the District of Columbia or a possession of the United States, as required by section 170(c)(2)(A) of the Code. If the organization does not qualify under section 170(c)(2)(A) of the Code-that is, it was not created or organized in the United States, etc.-a contribution thereto is not deductible under section 170 of the Code. Dora F. Welti v. Commissioner , 1 T.C. 905 (1943); Muzaffer ErSelcuk et al. v. Commissioner , 30 T.C. 962 (1958). It must further be found that the recipient was organized and operated exclusively for one of the purposes stated in section 170(c)(2)(B) of the Code, namely, religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals, and that it meets the remaining requirements of section 170(c)(2) of the Code.

Assuming that an organization otherwise meets the requirements set forth in section 170(c)(2) of the Code, a further problem arises where that organization is required to turn all or part of its funds over to a foreign charitable organization. As noted above, contributions directly to the foreign organization would not be deductible. The question presented here is whether the result should differ when funds are contributed to a domestic charity which then transmits those funds to a foreign charitable organization.

Prior to the passage of the Revenue Act of 1938 there were no restrictions as to the place of creation of charitable organizations to which individuals might make deductible contributions. (Section 102(c) of the Revenue Act of 1935, which first permitted a deduction for corporate charitable contributions, limited that deduction to contributions to ‘domestic' organizations which used such contributions within the United States.) The rule as to individual contributions was changed with the passage of the Revenue Act of 1938. Section 23(o) of that Act provided that contributions by individuals were deductible only if the recipient was a ‘domestic’ organization. See discussion of that section in Ways and Means Committee Report, H.R. Report No. 1860, Seventy-fifth Congress, Third Session, C.B. 1939-1 (Part 2), 728, at 742. Section 224 of the Revenue Act of 1939 substituted for the requirement that a qualifying organization be ‘domestic,’ the requirement that it have been ‘created or organized in the United States or in any possession thereof,’ etc. In substantially the same form, this requirement was re-enacted as section 170(c)(2)(A) of the 1954 Code.

At the outset, it should be noted that section 170(c)(2) (A) of the Code relates only to the place of creation of the charitable organization to which deductible contributions may be made and does not restrict the area in which deductible contributions may be used. Compare the last sentence in section 170(c)(2) of the Code, which requires that certain corporate contributions be used within the United States. Accordingly, the following discussion should not be construed as limiting in any way the geographical areas in which deductible contributions by individuals may be used.

The deductibility of the contributions here at issue will be discussed in connection with five illustrative examples set out below. The ‘foreign organization’ referred to in each of the examples is an organization which is chartered in a foreign country and is so organized and operated that it meets all the requirements of section 170(c)(2) of the Code excepting the requirement set forth in section 170(c)(2)(A) of the Code. The ‘domestic organization' in each example is assumed to meet all the requirements in section 170(c)(2) of the Code. In each case, the question to be decided is whether the amounts paid to the domestic organization are deductible under section 170(a) of the Code.

(1) In pursuance of a plan to solicit funds in this country, a foreign organization caused a domestic organization to be formed. At the time of formation, it was proposed that the domestic organization would conduct a fund-raising campaign, pay the administrative expenses from the collected fund and remit any balance to the foreign organization.

(2) Certain persons in this country, desirous of furthering a foreign organization's work, formed a charitable organization within the United States. The charter of the domestic organization provides that it will receive contributions and send them, at convenient intervals, to the foreign organization.

(3) A foreign organization entered into an agreement with a domestic organization which provides that the domestic organization will conduct a fund-raising campaign on behalf of the foreign organization. The domestic organization has previously received a ruling that contributions to it are deductible under section 170 of the Code. In conducting the campaign, the domestic organization represents to prospective contributors that the raised funds will go to the foreign organization.

(4) A domestic organization conducts a variety of charitable activities in a foreign country. Where its purposes can be furthered by granting funds to charitable groups organized in the foreign country, the domestic organization makes such grants for purposes which it has reviewed and approved. The grants are paid from its general funds and although the organization solicits from the public, no special fund is raised by a solicitation on behalf of particular foreign organizations.

(5) A domestic organization, which does charitable work in a foreign country, formed a subsidiary in that country to facilitate its operations there. The foreign organization was formed for purposes of administrative convenience and the domestic organization controls every facet of its operations. In the past the domestic organization solicited contributions for the specific purpose of carrying out its charitable activities in the foreign country and it will continue to do so in the future. However, following the formation of the foreign subsidiary, the domestic organization will transmit funds it receives for its foreign charitable activities directly to that organization.

It is recognized that special earmarking of the use or destination of funds paid to a qualifying charitable organization may deprive the donor of a deduction. In S. E. Thomason v. Commissioner , 2 T.C. 441 (1943), the court held that amounts paid to a charitable organization were not deductible where the contributions were earmarked for the benefit of a particular ward of the organization. Similarly, see Revenue Ruling 54-580, C.B. 1954-2, 97. These cases indicate that an inquiry as to the deductibility of a contribution need not stop once it is determined that an amount has been paid to a qualifying organization; if the amount is earmarked, then it is appropriate to look beyond the fact that the immediate recipient is a qualifying organization to determine whether the payment constitutes a deductible contribution.

Similarly, if an organization is required for other reasons, such as a specific provision in its charter, to turn contributions, or any particular contribution it receives, over to another organization, then in determining whether such contributions are deductible it is appropriate to determine whether the ultimate recipient of the contribution is a qualifying organization. It is well established in the law of taxation that ‘A given result at the end of a straight path is not made a different result because reached by following a devious path.' Minnesota Tea Co. v. Helvering , 302 U.S. 609, at 613, Ct. D. 1305, C.B. 1938-1, 288; George W. Griffiths v. Helvering , 308 U.S. 355, at 358, Ct. D. 1431, C.B. 1940-1, 136. Moreover, it seems clear that the requirements of section 170(c)(2)(A) of the Code would be nullified if contributions inevitably committed to go to a foreign organization were held to be deductible solely because, in the course of transmittal to the foreign organization, they came to rest momentarily in a qualifying domestic organization. In such cases the domestic organization is only nominally the donee; the real donee is the ultimate foreign recipient.

Accordingly, the Service holds that contributions to the domestic organizations described in the first and second examples set forth above are not deductible. Similarly, those contributions to the domestic organization described in the third example which are given for the specific purpose of being turned over to the foreign organization are held to be nondeductible.

On the other hand, contributions received by the domestic organization described in the fourth example will not be earmarked in any manner, and use of such contributions will be subject to control by the domestic organization. Consequently, the domestic organization is considered to be the recipient of such contributions for purposes of applying section 170(c) of the Code. Similarly, the domestic organization described in the fifth example is considered to be the real beneficiary of contributions it receives for transmission to the foreign organization. Since the foreign organization is merely an administrative arm of the domestic organization, the fact that contributions are ultimately paid over to the foreign organization does not require a conclusion that the domestic organization is not the real recipient of those contributions. Accordingly, contributions by individuals to the domestic organizations described in the fourth and fifth examples are considered to be deductible.

Pursuant to the authority contained in section 7805(b) of the Code, the principles stated herein will not be applied to disallow deductions for contributions made to a charitable organization prior to December 9, 1963, the date of publication of this Revenue Ruling, if those contributions otherwise would have been deductible under an outstanding ruling or determination letter.

Internal Revenue Service
Revenue Ruling

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Rev. Rul. 66-79

1966-1 C.B. 48

Sec. 170

IRS Headnote

Contributions to a domestic charity described in section 170(c)(2) of the Internal Revenue Code of 1954 which are solicited for a specific project of a foreign charitable organization are deductible under section 170 of the Code where the domestic charity has reviewed and approved the project as being in furtherance of its own exempt purposes and has control and discretion as to the use of the contributions.

Revenue Ruling 63-252, C.B. 1963-2, 101, amplified.

Full Text

Rev. Rul. 66-79

The Internal Revenue Service has been requested to clarify Revenue Ruling 63-252, C.B. 1963-2, 101 with respect to the deductibility of contributions to a domestic charitable corporation which may solicit contributions for a specific project of a foreign charity in the manner presented below.

X corporation is a domestic charitable organization formed under the nonprofit laws of the state of Y . It is exempt from Federal income tax as being organized and operated exclusively for charitable, educational, and scientific purposes described in section 501(c)(3) of the Internal Revenue Code of 1954. Contributions to it are deductible since it is an organization described in section 170(c)(2) of the Code.

The corporation's charter provides, in part, that in furtherance of its educational, scientific, and charitable purposes it shall have the power to receive and allocate contributions, within the discretion of the board of directors, to any organization organized and operated exclusively for charitable or educational purposes within the meaning of section 501(c)(3) of the Code.

In contrast to the broad generality of the purposes stated in its charter, the name X corporation suggests a purpose to assist a named foreign organization. The individuals who organized X corporation had become interested in furthering the work of the named foreign organization, a corporation organized and operated in a foreign country exclusively for charitable, scientific, and educational purposes. The individuals concerned, who are United States citizens not acting on behalf of the foreign organization, did not wish X corporation to function simply as a fund raising medium for the foreign organization. Instead, they were interested in raising funds for specific projects, such as scientific research projects, to be carried out by the foreign organization, or individuals connected with the foreign organization, pursuant to grants previously reviewed and approved by the board of directors of X corporation.

The bylaws of X corporation provide, in part, that: (1) The making of grants and contributions and otherwise rendering financial assistance for the purposes expressed in the charter of the organization shall be within the exclusive power of the board of directors; (2) in furtherance of the organization's purposes, the board of directors shall have power to make grants to any organization organized and operated exclusively for charitable, scientific or educational purposes within the meaning of section 501(c)(3) of the Code; (3) the board of directors shall review all requests for funds from other organizations, shall require that such requests specify the use to which the funds will be put, and if the board of directors approves the request, shall authorize payment of such funds to the approved grantee; (4) the board of directors shall require that the grantees furnish a periodic accounting to show that the funds were expended for the purposes which were approved by the board of directors; and (5) the board of directors may, in its absolute discretion, refuse to make any grants or contributions or otherwise render financial assistance to or for any or all the purposes for which funds are requested.

The bylaws also provide that after the board of directors has approved a grant to another organization for a specific project or purpose, the corporation may solicit funds for the grant to the specifically approved project or purpose of the other organization. However, the board of directors shall at all times have the right to withdraw approval of the grant and use the funds for other charitable, scientific or educational purposes.

In accordance with the provisions of its charter and bylaws, X corporation at times solicits contributions which are to be used to provide grants to the foreign organization mentioned above, or to individuals connected with such foreign organization, for specific purposes approved by X corporation's board of directors in accordance with its bylaws. At all times all of the pertinent facts, including the fact that the board of directors may withdraw its approval of a particular grant even after it has been made, are available to any contributor not previously informed of such facts should the contributor so request either before or after a contribution has been made. The corporation refuses to accept contributions so earmarked that they must in any event go to the foreign organization.

Section 170(a) of the Code provides, in part, that there shall be allowed as a deduction any charitable contribution as defined in subsection (c), payment of which is made within the taxable year.

Section 170(c) of the Code defines a charitable contribution as meaning, in part, a contribution or gift to or for the use of a corporation, trust, or community chest, fund or foundation which is organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals. However, the organization must be created or organized in the United States or in any possession thereof, or under the law of the United States, any State or Territory, the District of Columbia, or any possession of the United States.

Revenue Ruling 63-252, C.B. 1963-2, 101, discusses the deductibility of contributions by individuals to a charity organized in the United States which thereafter transmits some or all of its funds to a foreign charitable organization. Example (4) of that ruling concerns a domestic organization described in section 170(c) of the Code which makes grants to a foreign organization for purposes which the domestic organization has reviewed and approved as in furtherance of its purposes. Contributions to the domestic organization are not earmarked in any manner for a foreign organization and the use of such contributions is subject to control by the domestic organization. For these reasons, the domestic organization is considered to be the recipient of such contributions within the meaning of section 170(c)(2) of the Code.

Under the provisions of its charter and bylaws, X corporation may make grants to any organization organized and operated exclusively for charitable, scientific, or educational purposes within the meaning of section 501(c)(3) of the Code. An organization described in that section can be either a domestic or a foreign organization. The operations of X corporation bring it within the purview of example (4) of Revenue Ruling 63-252except for the manner in which it may solicit contributions for its foreign grants. This raises a question as to whether the contributions are earmarked for the foreign organization so as to prohibit a deduction under section 170 of the Code.

Revenue Ruling 62-113, C.B. 1962-2, 10, holds that where gifts to an organization described in section 170(c) of the Code are not earmarked by the donor for a particular individual, the deduction will be allowable where it is established that a gift is intended by the donor for the use of the organization and not as a gift to an individual for whose benefit the amount given may be used by the donee organization. The test in each case is whether the organization has full control of the donated funds, and discretion as to their use, so as to insure that they will be used to carry out its functions and purposes.

In the instant case the domestic corporation may only solicit for specific grants when it has reviewed and approved them as being in furtherance of its purposes. Furthermore, under the terms of its bylaws the domestic corporation may make such solicitations only on the condition that it shall have control and discretion as to the use of the contributions received by it. Therefore, contributions received by the domestic organization from such solicitations are regarded as for the use of the domestic corporation and not for the organization receiving the grant from the domestic organization.

Accordingly, contributions paid to the domestic organization under the circumstances described above are deductible, for Federal income tax purposes, in the manner and to the extent provided by section 170 of the Code.