

The Charitable Deduction Games: Are the Laws in Your Favor?

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Abstract

The article considers why the United States only grants a deduction for charitable contributions made to US charities from a historic standpoint and why doing so is problematic in the fight against global ills. The Charitable Deduction Games examines an alternative approach to cross-border giving that is currently spreading throughout the European Union (“EU”) as a result of the 2009 landmark case Hein Persche v. Finanzamt Ludenscheid. After an examination of Persche, the article explores the UK model that has resulted in response to the decision and considers why the US should adopt a similar model. Next, the article considers why the Netherlands has been reluctant to adopt a similar model in light of its historic stance. Finally, The Charitable Deduction Games examines the responses of various EU Member States to Persche and concludes with a proposal of how Persche should affect US laws governing cross-border giving.

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INTRODUCTION

In today's charitable world, many of the causes that have captured the attention of global philanthropists and organizations alike are international in nature. Gone are the days when US charities and the individuals and corporations who give to them are focused only on what is happening within the borders of the US in spite of economic hardship at home. In 2008, international funding represented almost 25% of overall giving in the US.¹ Most of the international grants comprising the recent growth in this area were exceptionally large, at \$10 million or more.² Also, significantly, the vast majority of the funders were independent foundations, rather than corporate foundations, which suggests individual donors are more focused on international philanthropic goals, and thus, laws that affect their behavior should be scrutinized carefully.³

As new international funders enter the global giving scene, it is clear that alleviating suffering abroad and world plights is on the conscience of American philanthropists. Significantly, one independent foundation, the Bill & Melinda Gates Foundation ("Gates Foundation"), accounted for more than two out of five international grant dollars in 2008 and provided almost 44 percent of international grant dollars.⁴ One of the largest new funders is the Gordon and Betty Moore Foundation, a California foundation which gave \$115,376,014 in international grant dollars in 2008.⁵

Should not a philanthropic CEO of a major US corporation who has donated to the American Red Cross be able to make the same tax-efficient donations to its UK equivalent if he has had to relocate to London? Should we require instead that the UK charity set up a US charity or seek administratively burdensome registration in the US? Both of these options come at a price that could be used to provide disaster relief rather than to circumvent a perhaps well-meaning but misplaced set of rules. The barrier to the CEO's giving is the result of a notion present not only in the US's set of charitable giving rules but also in those of the UK and most European Union ("EU") countries. I will refer to that notion as the "notion of territoriality."

The notion of territoriality is a country's restriction of income tax deductibility to those donations made to charities formed within its given borders, and not allowing deductibility for donations made to charities formed in other countries ("foreign charities"). Both US and UK charitable laws have afforded primacy to this notion, whereas since 2008, the charitable laws of the Netherlands stand in sharp contrast; after a landmark decision by the European Court of Justice,⁶ the laws of most EU member states provide an even more pronounced contrast. A few years ago, the Netherlands became the first country to provide a full income tax deduction to charities established within the EU or in the US (i.e., to significantly diminish the importance of the notion of territoriality in its cross-border charitable law framework). Interestingly, the UK has modified its law significantly, and

¹ Steven Lawrence & Reina Mukai, *International Grantmaking Update: A Snapshot of U.S. Foundation Trends*, FOUND. CTR. (Dec. 2010), http://foundationcenter.org/gainknowledge/research/pdf/intl_update_2010.pdf (explaining that corporate foundations were responsible for 4.8% of international grant dollars expended).

² *Id.*

³ *Id.* (noting that independent foundations were responsible for 92% of the 2008 international grant dollars given).

⁴ *Id.*

⁵ *Id.*

⁶ Case C-318/07, *Hein Persche v. Finanzamt Ludenscheid*, 2009 E.C.R. I-359.

in comparison with the UK and other EU member states, the Netherlands has fallen behind in the march towards helping donors give internationally.⁷ At the same time, the notion of territoriality in practice alleviates some concerns about oversight and the funneling of donated funds to terrorist activities. While the complexities associated with implementing a revised cross-border charitable deduction regime that takes account of these concerns will be more fully explored in the second article of this series, this article presents the issue and introduces a framework for a comprehensive solution based on prior efforts to confront the problem.

The notion of territoriality is endemic in the charitable laws of the US, the UK, and the EU, particularly the Netherlands. This article will address aspects of the notion of territoriality in all three sets of charitable laws. Part I of this article will define the notion of territoriality and examine the historical reasons for it; Part II will discuss why the notion of territoriality is problematic; and Part III will explore the solution proposed by the EU in a landmark case and how the US may adapt its laws in light of the change and historic notions discussed.

I. THE NOTION OF TERRITORIALITY: DEFINED, HISTORICALLY EXAMINED, AND FOUND WANTING

The charitable laws of the US and of other nations reflect the notion of territoriality or the restriction of tax relief to those charitable contributions made only to domestic charities. Following is an examination of the US charitable law setting forth this notion and its historical underpinnings. I also will examine this notion in regard to the UK and other EU member states.

A. US – Current Notion of Territoriality

Donors are allowed US income tax deductions for charitable contributions made to or for the use of charities created or organized in the US, or in any US possession or those formed under the laws of the US, any State, the District of Columbia, or any US possession (“US domestic charities”).⁸ Noted tax scholar David Pozen refers to the notion of territoriality as “our water’s edge policy” and explains that it conditions “income tax deductibility on the donee’s domestic situs.”⁹ The only exceptions to the notion of territoriality appear in the context of estate and gift taxation contributions¹⁰ and those made in regard to certain bilateral tax treaties the US has with Israel, Canada, and Mexico.¹¹ It is important to note that foreign charities have always been eligible to apply for US tax-exempt status,¹² but practically speaking this is not an option since it would force the charity to convert all of its accounting to US dollars and methods (i.e., GAAP), and force compliance with the annual IRS filing requirement (i.e., Form 990 or 990-PF), which is impractical and costly if the foreign charity is using a different fiscal year. Even if a foreign

⁷ *Taxation: Commission refers The Netherlands to Court over tax discrimination against foreign charities*, EUROPA (Apr. 6, 2011), <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/429> (citing § 60 of Case C-318/07, *Hein Persche*, 2009 E.C.R. I-359).

⁸ I.R.C. § 501(c)(3) (2012).

⁹ David E. Pozen, *Remapping the Charitable Deduction*, 39 CONN. L. REV. 531, 540 (2006).

¹⁰ See I.R.C. §§ 2055, 2522 (2012). Cf. I.R.C. §§ 2522(b)(2)–(3), 2106(a)(2)(A)(ii) (2012) which impose restrictions related to the notion of territoriality on nonresidents in the context of estate and gift taxation. See also Pozen, *supra* note 9.

¹¹ See, e.g., Pozen, *supra* note 9.

¹² See, e.g., Rev. Rul. 66-177, 1966-1 C.B. 132.

charity were to obtain US tax-exempt status, donors who made US contributions to it would not receive US tax deductions because of the notion of territoriality.¹³ Thus, generally speaking, donors do not receive US income tax deductions for charitable contributions to foreign charities.

Donors may still fund foreign charitable activities provided they use a US intermediary. Specifically, there are two options available for donors desiring to receive a US tax deduction for a contribution that funds foreign charitable activities: a non-corporate donor may make a donation to a US charity (1) that is engaged in foreign charitable activities itself or (2) that will make a decision to fund a foreign charity engaging in such activity.¹⁴ The historic reasons advanced for this peculiar notion form a web of ambiguity, which suggests the notion was ill-founded and lends support to an argument the notion should be afforded less primacy in US charitable giving law.

B. US – History of the Notion of Territoriality

In examining the history of the notion of territoriality in the US, one discovers that it was not always present in our tax law. In early days, the income tax law in the US allowed US tax deductions for charitable contributions to foreign charities. The restriction to only US charities did not appear until over twenty years later. From 1917–1938, the notion of territoriality simply did not exist in the context of individual tax deductions and was born with the enactment of the Revenue Act of 1938.¹⁵ Perhaps more tellingly, the reasons advanced for the notion of territoriality, evident in the following quote from the legislative history of the Revenue Act of 1938, have long been disputed as inaccurate and ill-founded:¹⁶

The exemption from taxation of money or property devoted to charitable or other purposes is based upon the theory that the Government is compensated for the loss of revenue by its relief from financial burdens which would otherwise have to be met by appropriations from public funds and by benefits resulting from the promotion of general welfare. The United States derives no such benefit from gifts to foreign institutions, and the proposed limitation is consistent with the above theory. If the recipient, however, is a domestic organization the fact that some portion of its funds is used in other countries for charitable and other purposes (such as missionary and educational purposes) will not affect the deductibility of the gift.¹⁷

Tax scholars have rightly taken issue with the historical reason advanced for the notion of territoriality. From an ideological standpoint, it does not make sense. Professor

¹³ I.R.C. § 170(c)(2) (2012).

¹⁴ See Pozen, *supra* note 9, at 541 (citing Rev. Rul. 63-252, 1963-2 C.B. 101.).

¹⁵ The Revenue Act of 1938 introduced the notion of territoriality in the context of corporate charitable deductions by only granting tax deductions to donations made to US charities and, where the charity was not a corporate entity, donations for domestic use. See Pozen, *supra* note 9, at 542; JAMES J. FISHMAN & STEPHEN SCHWARZ, *TAXATION OF NONPROFIT ORGANIZATIONS: CASES AND MATERIALS* 696 (4th ed. 2010).

¹⁶ Eric M. Zolt, *Tax Deductions for Charitable Contributions: Domestic Activities, Foreign Activities, or None of the Above*, 63 HASTINGS L.J. 361 (2012).

¹⁷ H.R. Rep. No. 75-1860, at 19–20 (1938).

Harvey Dale's renowned article on international deductions addresses some of the problems with the notion of territoriality.¹⁸

The notion of territoriality has been described correctly as "bad history, bad philosophy, and bad logic."¹⁹ In terms of the first critique of "bad history," there is no former congressional requirement that only contributions to charities that relieve the US government of an expense should entitle donors to a US tax deduction.²⁰ As Pozen notes, "No one today would defend the drafters' argument that foreign charities should not receive deductible gifts because, unlike domestic charities, they do not alleviate governmental burdens."²¹ Pozen argues that if this were the case, the rule would be both under-inclusive and over-inclusive. In terms of the former, he states there are nonprofits that entitle donors to a tax deduction, such as religious organizations, which do not provide governmental services.²² Pozen also comments that it would be over-inclusive since many for-profit contractors do provide governmental services but donations to them are not tax deductible.²³ (While I agree with Pozen's overall characterization of the drafters' reason as indefensible, I would disagree with his point about religious charities given the number of churches which run programs to assist with the poor and homeless.)

In addition, if the drafters' historical reason for the notion is accurate, it would mean that our approach to US income tax deductibility is riddled with inconsistency. Clearly, there are numerous US charities that engage in charitable work that the US government does not endeavor to undertake. Nevertheless, donors to such US charities receive a US income tax deduction. What about foreign charities that engage in foreign charitable work that the US government does in fact undertake? Are not those foreign charities relieving the US government of an expense, specifically foreign aid? There must be another salient feature that leads to tax deductibility, and many academics have addressed this issue. My point is that the historical reason on record is an inadequate one. It cannot possibly serve as an accurate justification for the rule.

It has also been argued that the historical reason advanced is "bad philosophy."²⁴ The thought expressed in the legislative history reflects a limited worldview and perspective of global philanthropy.²⁵ If the US adopted the type of philosophy underlying the drafters' argument, it would quickly find that accusations of isolationism and even indifference would result. This is also a valid criticism although perhaps the least persuasive in terms of a legal analysis of the problem; as a result, I will devote more attention to the final criticism.

Finally, the historic reason advanced evinces "bad logic."²⁶ Why should we deny a US tax deduction based on where the charity is formed (i.e., deny a deduction in the case of a foreign charity) when we do not limit where a US charity may carry out its charitable activity (i.e., permit a deduction in the case of a US charity engaged in foreign charitable

¹⁸ Harvey P. Dale, *Foreign Charities*, 48 *TAX LAW*. 655 (1995).

¹⁹ *Id.* at 660–61.

²⁰ See Zolt, *supra* note 16, at 391.

²¹ Pozen, *supra* note 9, at 545.

²² *Id.*

²³ *Id.*

²⁴ Dale, *supra* note 18, at 661.

²⁵ *Id.*

²⁶ *Id.*

work)?²⁷ The Internal Revenue Code (“Code” or “I.R.C.”) and tax precedent has no shortage of references to the prevailing nature of substance over form in the administration of tax law. If in substance a foreign charity and a US charity are the same, one may argue that their respective places of incorporation should not operate to negate a benefit otherwise due. Allowing the triumph of form, and specifically residence, has caused a number of problems in the offshore world, and these lessons should inform our conception of current cross-border charitable law. Allowing taxpayers to game the system and to defer US tax simply by incorporating in a certain jurisdiction, without much regard to the substance of business being conducted there, has led to a host of problems and lost revenue.²⁸ Have we not learned the importance of looking through places of incorporation to determine what is being done, i.e., examining substance? In the cross-border charitable giving world, the substance of the work done by a foreign charity and a US charity may be the exact same. In the US, a charity that allows a donor to receive a tax deduction must have the substance of I.R.C. section 501(c)(3). In other words, it must be organized and operated exclusively for one of the purposes listed in this provision, namely, *inter alia*, a “religious, charitable, scientific, literary, or educational purpose.”²⁹ Under a pivotal case from 1980, the Internal Revenue Service (“IRS”) held that such an accepted charitable purpose may be carried out completely abroad.³⁰ If a foreign charity is also established for one of the accepted charitable purposes under I.R.C. section 501(c)(3), the substance of what it is doing has already been approved as entitling donors to a tax deduction (even if the work is carried out completely abroad). If we have decided the substance of a charity merits a tax deduction for a donor, then why should such a deduction be denied based on form, or in other words, where it has been incorporated?

In some cases, the substance of what foreign charities are doing may exceed what US charities are doing in terms of carrying out a given charitable purpose. One advantage, as Professor Eric Zolt points out, of placing US and foreign charities on par with each other is that it would foster having tax subsidies go to the charities that are “the most efficient providers of charitable services.”³¹ Arguably, foreign charities that are more effective providers should receive more favor from the US system than less effective US charities. As the US charitable law currently stands, more effective foreign charities are not receiving even the same treatment as less effective US charities. I would argue that residence in the charitable context could be tied to where the work is occurring, and if that is the case, US charities conducting their charitable activities abroad should be deemed akin to foreign charities that are doing the same. The only difference is where a few pieces of paper were filed.

In addition, Dale suggests that the notion of territoriality is bad logic because if in fact the reason for it is to reduce the burden on the IRS in regard to oversight of charitable funds used abroad, this end may be accomplished through less drastic means than requiring a US intermediary.³² For example, he notes that the existing Code provisions regarding oversight could simply be strengthened to accomplish this objective.³³ Perhaps even more

²⁷ *Id.*

²⁸ Michael J. Burns & James McConvill, *An Unstoppable Force: The Offshore World in a Modern Global Economy*, 7 HASTINGS BUS. L.J. 205, 205 (2011).

²⁹ I.R.C. § 501(c)(3) (2012).

³⁰ See *Bilingual Montessori Sch. of Paris v. Commissioner*, 75 T.C. 480 (1980).

³¹ See Zolt, *supra* note 16, at 392.

³² See Dale, *supra* note 18, at 663 nn.39–40.

³³ *Id.* at 663.

persuasively, the legislative history does not necessarily reflect any such concern with this burden in the first instance.³⁴

In attempting to find a historic reason for this notion, the searcher will leave empty-handed. Dale comments, “Congress has never provided a satisfactory explanation for a rule that, at least on gross examination, has an isolationist scent and that is, on the other hand, easily bypassed.”³⁵ It has been posited that the notion of territoriality in the US is now “archaic,” specifically, a by-product of the Depression Era when the US was focused “inward on national recovery” and thus reflective of “an isolationist foreign policy.”³⁶

I. Implementation as Justification

Although the initial drafters did not mention implementation as a reason for the notion of territoriality, observers and scholars incorrectly have touted it as the main reason it should remain a central part of US charitable giving law.³⁷ Oversight and administrability are the primary concerns advanced.³⁸ Dale considers the argument that a US intermediary leads to simpler IRS oversight, but he ultimately rejects it.³⁹ As an alternative, Dale asserts that a reporting system that entails more complete substantiation of foreign gifts and that operates within existing IRS rules would be a better solution.⁴⁰ “Friends of” organizations have been seen as a way to ease the burden on the IRS in terms of collecting and auditing foreign-based documents and records.⁴¹ As Dale points out, “there are other more suitable methods” for accomplishing this goal.⁴² One solution he proposes involves placing a larger burden on donors: donors would be required to substantiate their foreign charitable deductions under current Code section 170(f)(8).⁴³ Code section 170(f)(8) requires donors to obtain substantiation in order to receive a deduction.⁴⁴ It also authorizes regulations that will “carry out” this requirement.⁴⁵ Dale advocates placing the burden on the donor since he/she will work harder at complying because the deduction will be at stake.⁴⁶

As Pozen posits, implementation should be based on a view of what an international deduction policy should achieve.⁴⁷ Issues associated with implementation and a proposal for an implementation strategy will be addressed more fully later in this article and in a subsequent one.⁴⁸ Confining the examination for now to the historic reason

³⁴ Pozen, *supra* note 9, at 543; Dale, *supra* note 18, at 663.

³⁵ John G. Simon, Laura B. Chisolm & Harvey P. Dale, *The Federal Tax Treatment of Charitable Contributions* 1, 15–16 (June 25, 2005) (unpublished manuscript) (on file with the Connecticut Law Review) (citation omitted).

³⁶ See Penina Kessler Lieber, *1601–2001: An Anniversary of Note*, 62 U. PITT. L. REV. 731, 741 (2001).

³⁷ See Pozen, *supra* note 9, at 545.

³⁸ *Id.*

³⁹ See Dale, *supra* note 18, at 663.

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

⁴⁴ See I.R.C. § 170(f)(8) (2012).

⁴⁵ See Dale, *supra* note 18, at 696 n.40.

⁴⁶ See *id.*

⁴⁷ Pozen, *supra* note 9, at 545.

⁴⁸ This article is the first in a three-part series.

advanced for the notion of territoriality results in no other determination than an absence of real justification.

2. *Inconsistency with Other Charitable Giving Provisions*

The notion of territoriality seems to cut against some basic underlying policies the Code seeks to achieve. First, it is not a consistently applied principle within the area of charitable giving. Putting aside the argument that internationally-targeted donations, whether made to US charities or to foreign charities, should not result in a tax deduction,⁴⁹ if one considers the present state of charitable law, it is inescapable that it is wrought with inconsistency. Nor can one argue that the notion of territoriality is embodied as a concept broadly in US charitable law. It seems to apply only in the context of tax deductions. Neither the income tax exemption nor the estate and gift tax charitable deductions embody the notion.⁵⁰ In other words, as stated earlier, there is no impediment to a foreign charity filing for tax-exempt status or to a donor that desires to make an estate and gift donation to a non-US charity (in most cases) in terms of receiving a tax deduction for such a donation. At the same time, as one academic has noted, one could argue that this notion is consistent with the Code's goal of making international giving more difficult than domestic giving.⁵¹ However, it is not clear that the difficulty should be of sufficient magnitude to serve as deterrence to international philanthropy.

An examination of the history of the notion is not complete without an observation of its exceptions, and thus, they deserve attention as well. Following is an overview of some salient portions of US charitable tax law that ignore the notion.

a. Estate Tax and Gift Tax Deduction

As mentioned earlier, the notion of territoriality is not embodied in the charitable laws regarding US estate and gift tax deductions.⁵² In other words, donors may receive US estate and gift tax deductions for gifts to a US charity or a foreign charity. Expressed simply, the notion of territoriality does not apply in the context of estate and gift tax deductions. One must ask what makes estate and gift tax deductions merit special treatment and whether the same obstacles advanced as reasons to deny an income tax deduction under similar circumstances have been overcome in this area.

b. Donations by Non-Charitable Domestic Trusts

Under I.R.C. section 642, a trust permitted or required to make charitable contributions may receive a US income tax deduction for contributions to foreign charities and foreign governments. Thus, “[c]ontributions to a foreign charity by a [section 642] trust . . . , for purposes described in [section] 170(c) are . . . deductible and, in addition, there are no percentage limitations on the amount of distributed income for which a

⁴⁹ See Pozen, *supra* note 9, at 545.

⁵⁰ See, e.g., Pozen, *supra* note 9, at 543.

⁵¹ See, e.g., Darryll K. Jones, *The Neglected Role of International Altruistic Investment in the Chinese Transition Economy*, 36 GEO. WASH. INT'L L. REV. 71, 118, 119–24 (2004) (citation omitted) (noting the following: IRS classification of unregistered charities as foundations, foreign tax credit's failure to take into account international donations, and penalties applied on foundations that make non-US grants unless exacting “expenditure responsibility” is exercised.)

⁵² See I.R.C. §§ 2055, 2522 (2012).

deduction may be claimed.”⁵³ A deduction is allowed for “any contribution made for a purpose under [section] 170(c) *without* the limitations of [section] 170(c)(2)(A) [or in other words the notion of territoriality].”⁵⁴ Not only is a deduction allowed for donations to foreign charities, but, additionally, the percentage limitations affecting donations by US individuals and US business corporations are not applicable. An observation of the laws regarding tax deductions for trusts shows under-regulation in comparison to the individual context. There is a sharp deviation from the notion of territoriality.

c. Treaties in Force

US treaties with Israel, Canada, and Mexico provide exceptions to the notion of territoriality. In other words, donors may receive a deduction for contributions to Israeli, Canadian, or Mexican charities. Following is an examination of these provisions:

Israel

Pursuant to Article 15A(1) of the US-Israel Income Tax Treaty,⁵⁵ a US citizen or resident may receive a US income tax deduction for a donation to an Israeli charity that is (1) recognized as a charity under Israel’s income tax laws and (2) would be eligible to be treated as a US charity had it been formed in the US. The amount of the US income tax deduction is limited to 25% of the donor’s Israel income. Under Article 15A(2), Israeli residents who donate to US charities may receive tax relief in Israel and thus reciprocity exists. As suggested earlier, this treaty exception seems to place the expected emphasis on substance, rather than “form.” If an Israeli charity has the same substance as a US charity qualified to accept tax deductible donations, donors to it will be allowed a US tax deduction.

Canada

Pursuant to Article XXI(5) of the US-Canada Income Tax Treaty,⁵⁶ a US citizen or resident may receive a US income tax deduction for a donation to a Canadian charity that (1) is treated essentially as a charity by Canada and (2) would be eligible to be treated as a US charity if it were formed in the US, subject to certain limitations on amount.⁵⁷ Under Article XXI(6), there is an element of reciprocity under Canadian law in that Canadian residents making donations to US charities may receive Canadian tax relief. Again, one observes that substance trumps form under this treaty exception as well: donations to Canadian charities akin to US charities in terms of their substance or purpose will be eligible for US income tax deductions.

Mexico

Similarly, pursuant to Article 22(2) of the US-Mexico Income Tax Treaty,⁵⁸ a US citizen or resident may receive a US income tax deduction for a donation to a Mexican

⁵³ Michael W. Galligan, *International Charitable Giving and Planning Under U.S. Tax Law*, TAX MGMT. EST. GIFTS AND TR. J., May-June 2004, at 7, available at <http://www.phillipsnizer.com/pdf/Article-MGIntlLawCharUSTax5-13-04.pdf>

⁵⁴ *Id.* (commenting that such trusts may only donate from their “gross income” in contrast to individual donors who may donate from income or capital and the absence of percentage limitations on the deduction).

⁵⁵ Convention with Respect to Taxes on Income, Nov. 20, 1975, U.S.-Isr., S. Exec. Doc. No. 94-2.

⁵⁶ Convention with Respect to Taxes on Income and on Capital, Aug. 16, 1984, U.S.-Can., 1980 U.S.T. 93.

⁵⁷ Galligan, *supra* note 53, at 7.

⁵⁸ Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Sept. 18, 1992, U.S.-Mex., S. Treaty Doc. No. 103-7.

public charity that is able to receive deductible contributions under Mexican law provided that the rules regarding such ability are essentially equivalent to those in the US. Again, under Article 22(3) the element of reciprocity exists under Mexican law in that Mexican residents making donations to US public charities may receive income tax deductions. Mexican charities “essentially equivalent to” US charities in substance, i.e., having a similar charitable purpose, are eligible to receive US income tax deductible contributions.

In all three cases, one observes that there are restrictions on the amount of the deduction. In some cases, the deduction must be taken against foreign source income.⁵⁹ However, the US treaty with Canada does provide that the deduction is not limited to Canadian income in certain circumstances.⁶⁰

d. Treaties Not in Force

While it is unlikely that treaty revision will be the avenue used to eliminate the notion of territoriality due to pecuniary costs,⁶¹ it is worth considering the historical reasons advanced for permitting treaty exceptions to the notion. The first income tax treaty that did away with the notion of territoriality, and therefore permitted a tax deduction for donations to a foreign charity, was the United States-Honduras Income Tax Convention,⁶² which lapsed in 1966.⁶³ An examination of the treaty exception evinces an approach similar to those already discussed. US taxpayers who made a contribution to a charity created in Honduras and operated for purposes akin to those in I.R.C. section 501(c)(3), i.e., religious, charitable, scientific, literary, or educational purposes, would receive an income tax deduction.⁶⁴ However, the deduction was limited to the amount of the donor’s Honduras source income.

If the proposed United States-Brazil Income Tax Convention had been ratified in the 1960s, it would have gone even further in the extension of US income tax deductions to donations to foreign, i.e., Brazilian charities, that qualified as exempt organizations under I.R.C. section 501(c)(3).⁶⁵ One other condition was that the donations had to be used solely in Brazil.⁶⁶ Assuming those conditions were met, it called for a charitable deduction against US source, rather than Brazilian income.⁶⁷

In examining current and historic departures from the notion of territoriality, three strong arguments in favor of extending tax deductions to donations made to foreign charities emerge. First, if it can be shown that the substance of a foreign charity is akin to that of a US charity, a US tax deduction is warranted. Related to this point is the foreign charity’s status under its own country’s laws. Second, there is a willingness to engage in

⁵⁹ See Nina J. Crimm, *Through A Post-September 11 Looking Glass: Assessing the Roles of Federal Tax Laws and Tax Policies Applicable to Global Philanthropy by Private Foundations and Their Donors*, 23 VA. TAX REV. 1, 49 (2003) (noting the deduction may be limited “to a percentage of the donor’s income from sources in the foreign country of the charitable donee organization”).

⁶⁰ There is an exception in the case of donations made to a Canadian college or university where the US donor or his/her family member is or was enrolled. In such cases, the deductible amount is not limited to Canadian income but rather the general limitations that apply under § 170. No equivalent exception applies in the case of Mexican colleges or universities. See Galligan, *supra* note 53, at 7–8.

⁶¹ See Crimm, *supra* note 59, at 49.

⁶² Convention for the Avoidance of Double Taxation, June 25, 1956, U.S.-Hond., 8 U.S.T. 219.

⁶³ See Crimm, *supra* note 59, at 50.

⁶⁴ *Id.*

⁶⁵ See *id.* at 51.

⁶⁶ *Id.*

⁶⁷ *Id.*

reciprocity. In other words, presumably the foreign countries have allowed their taxpayers to receive a deduction for donations to US charities. This could have interesting implications for the US in terms of additional revenue sources for US charities, which is an idea that will be elaborated upon in the second article of this series. Finally, overall relations with other foreign countries are bound to have been affected through such an allowance.

If one considers the drafters' historical reason for the notion of territoriality, which is relief of US governmental burden, at face value, it is not being borne out by the current charitable law regime. Arguably, donations to foreign charities help the US government in the same way that donations to US charities that in turn re-donate funds to foreign charities do.⁶⁸ Failure to provide donors with the same US tax benefit, which is merited based on the substance of the work the charity is performing as detailed in I.R.C. section 501(c)(3), leads to a proliferation of charities and inefficiencies. Allowing donations to foreign charities which are in substance the same as US charities could potentially lead to additional revenue streams for US charities given the likelihood of reciprocity as well.

II. WHY THE NOTION OF TERRITORIALITY IS PROBLEMATIC

The notion of territoriality is problematic not only from an ideological standpoint but from a practical standpoint as well. The next section of this article will address the inefficiencies resulting from an over-emphasis on the notion of territoriality in the context of the US income tax deduction. The section will conclude with an analysis of the overall effect on international cross-border giving.

A. Practical Standpoint

A recent Foundation Center Report, prepared in cooperation with the Council on Foundations, examined the funding of approximately 1,500 US foundations in 2008 which accounted for over four-fifths of total estimated international giving.⁶⁹ Between 2006 and 2008, international giving increased more rapidly than overall giving across all foundation types.⁷⁰ Interestingly, even in the wake of an economic crisis, US foundations that fund international activities did not waiver substantially in their funding.⁷¹ In 2009, international grantmaking, whether in terms of support for US-based international programs or cross-border recipients, declined approximately 4 percent in 2009, from a record high of \$7 billion in 2008 to \$6.7 billion.⁷² When adjusted for inflation, these figures reflect an actual decline in the value of international grants of less than 4 percent. Of particular note is the effect of the US's largest international funder and greatest philanthropic grantmaker, the Gates Foundation. If the Gates Foundation numbers were excluded, both overall foundation giving and international funding would have evinced an over 9 percent decline. Perhaps most tellingly, the 2008 survey of international funding "did not show a disproportionately large reduction relative to domestic support."⁷³

The main problem that the notion of territoriality causes in the area of international philanthropy is increased transaction costs. It is currently possible to receive a US tax

⁶⁸ See Joannie Chang et. al., *Cross-Border Charitable Giving*, 31 U.S.F. L. REV. 563, 569 (1997) (citation omitted).

⁶⁹ Lawrence & Mukai, *supra* note 1.

⁷⁰ *Id.* at 2.

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.*

deduction for a contribution to a foreign charity if one is willing to pay transaction costs.⁷⁴ Individual donors desiring a US income tax deduction often end up setting up US charities that make grants to foreign charities as a way to circumvent this rule. As mentioned earlier, US charities that re-donate funds to foreign charitable activities still entitle donors to a US income tax deduction provided certain safeguards are in place. This means that US income tax deductions are permitted even when a US charity funds a particular foreign charity. Such US charities are referred to as “friends of” organizations.⁷⁵ US charities are either classified as “public charities” or “private foundations.”⁷⁶ Generally, a public charity is one that receives donations from a broad section of the public whereas a private foundation is typically funded by only a few donors or even one family.⁷⁷ Relevantly, a US public charity may fund not only foreign charities but also non-charitable foreign entities as long as such funding is consistent with its own charitable purpose.⁷⁸ In contrast, private foundations are subject to many more restrictions in terms of use of their funds. Typically, private individuals or families will set up a private foundation because they are not taking in donations from a broad section of the public. Another option is to use a donor-advised fund, such as the Charities Aid Foundation;⁷⁹ however, it is common for extremely high net worth individuals to set up their own private foundations.

Foreign charities also end up setting up “friends of” organizations in the US, which typically qualify as US public charities. The “friends of” organizations then make grants to the foreign charities while carefully avoiding running afoul of the anti-conduit rules earmarking provisions.⁸⁰ In Revenue Ruling 66-1979, it was determined that donations to a US charity (i.e., a “friends of” organization), that “at times solicits contributions which are to be used to provide grants to [a] foreign organization . . . for specific purposes approved by [the US charity’s] board of directors” will be eligible for a US income tax deduction.⁸¹ As long as individual donations⁸² are made to a US “friends of” organization, they are eligible for a US income tax deduction, even if the funds ultimately end up in the hands of a foreign charity. “Friends of” organizations that comply with the requirements listed in this 1966 ruling⁸³ are thus a type of intermediary that may be used to circumvent the notion of territoriality.

However, the expense and administration associated with establishing a “friends of” organization, whether it is a public charity or a private foundation, detracts from time and resources that could otherwise be devoted to worthy international causes. Dale comments that mandating the use of a “friends of” organization in an increasingly global philanthropic world leads to unnecessary formalism while curtailing support for causes abroad.⁸⁴ There is some debate among commentators about the ability of a US charitable entity known as a “supporting organization” under section 509(a)(3), which has

⁷⁴ Zolt, *supra* note 16, at 391.

⁷⁵ Rev. Rul. 74-229, 1974-1 C.B. 142; Rev. Rul. 66-79, 1966-1 C.B. 48.

⁷⁶ I.R.C. § 509 (2012). *See also* Pozen, *supra* note 9, at 539.

⁷⁷ *See* Crimm, *supra* note 59, at 67-68.

⁷⁸ *See* Galligan, *supra* note 53.

⁷⁹ *See* CAF AMERICA, <http://www.cafamerica.org/about/how-we-work/> (last visited Nov. 8, 2013).

⁸⁰ *See* Rev. Rul. 71-460, 1971-2 C.B. 231.

⁸¹ Rev. Rul. 66-79, 1966-1 C.B. 48.

⁸² *See* I.R.C. § 170(c)(2) (2012) and Rev. Rul. 66-79, 1966-1 C.B. 48 (restricting donations by US business corporations to only corporate friends of organizations).

⁸³ *See, e.g.*, Rev. Rul. 66-79, 1966-1 C.B. 48.

⁸⁴ Dale, *supra* note 18, at 663.

overlapping board members with a foreign charity short of control, to be classified as a US public charity and thus collect charitable donations eligible for an income tax deduction.⁸⁵ However, the “friends of” organization model is accepted and common among global philanthropists.

In terms of putting the requirements into practice, unless it makes a determination that the foreign charity is equivalent to a US one, a “friends of” organization that is a private foundation must ensure that its re-donation of funds to a foreign charity or foreign charitable activity is consistent with its own charitable purpose and exercise some degree of supervision (known as “expenditure responsibility”) over the foreign charity’s use of the funds.⁸⁶ These requirements add considerably to the time and expense required to engage in international grantmaking. A “friends of” organization may need to undertake certain operational procedures such as written grant proposals and extensive monitoring of funds.⁸⁷

B. Ideological Standpoint

While difficulties associated with the notion of territoriality may keep lawyers well fed in hours, they do little to help feed the poor or marginalized around the world. According to the Global Poverty Project, a UK based charity, over 1.4 billion people currently live on less than \$1.25 per day.⁸⁸ The foundation of what “charitable” means in the US is based upon “Christian ideals, Roman precedents, and Common Law” that shaped the conception of law in medieval England.⁸⁹ Charity, or “philanthropy” as defined in scripture, “is an intensely personal commitment to following the example of Christ by healing the sick, feeding the poor, and helping the helpless.”⁹⁰ These goals were embodied in the definition of “charitable” in England’s Statute of Uses, which served as the basis for the equivalent provision in the US or I.R.C. section 501(c)(3). US charitable law should not restrict the ability of individuals to spend their resources and time embracing these goals. The right to love one’s neighbor as one’s self must be embodied in our notion of a right to life, liberty, and the pursuit of happiness, and surely that notion should remain more pronounced than an ill-conceived notion of territoriality.

Requiring individual philanthropists and groups of philanthropists to spend their resources on complying with formality instead of the substance of fulfilling needs is at odds with the concept of charity. Tax scholar Nina Crimm impugns the US government to “develop a global philanthropic policy that encourages greater financial participation by America’s citizens, corporations, and nonprofit organizations.”⁹¹ US charitable law should promote rather than provide costly obstacles to such philanthropic-minded individuals. The precautions underlying the present system may be met through other reporting mechanisms that could be deemed mandatory for foreign charities.

At the same time, one may argue that there is an underlying US policy to make donating to international causes more difficult, which is founded upon the desire to steer

⁸⁵ See Galligan, *supra* note 53.

⁸⁶ See Dale, *supra* note 18, at 663, 685 (noting the requirements for expenditure responsibility and the foreign equivalency test).

⁸⁷ See Crimm, *supra* note 59, at 83, 86.

⁸⁸ See *1.4 Billion Reasons – The Presentation*, THE GLOBAL POVERTY PROJECT (last visited Nov. 10, 2013), <http://www.globalpovertyproject.com/pages/presentation>.

⁸⁹ Peter Dobkin Hall, *The Statute of Charitable Uses and the English Origins of American Philanthropy*, <http://www.hks.harvard.edu/fs/phall/01.%20Charitable%20uses.pdf> (last visited Nov. 11, 2013).

⁹⁰ *Id.*

⁹¹ Crimm, *supra* note 9, at 1.

donor giving to domestic causes. In fact, as pointed out earlier, the notion of territoriality has long been associated with an isolationist foreign policy that was prevalent in the aftermath of the Depression Era.⁹² Certainly, the rules regarding in-kind donations to private foundations are geared toward making cross-border giving more difficult.⁹³ However, if that were the overall aim of US rules, again, one would wonder why the US permits a US charity to carry out its purposes solely abroad or to re-donate funds to foreign charities. As Pozen states, “our tax system privileges domestic altruism over international altruism, but incompletely.”⁹⁴ The inconsistency argument outlined in section I persists. Moreover, in terms of situating donations to international causes in a theory of why the charitable deduction exists, one may conclude that “internationally-targeted contributions . . . are more altruistic than domestic-targeted contributions.”⁹⁵ As Pozen declares, international giving provides a way for US citizens to own up to their responsibilities to the world in a way that foreign aid by the US does not.⁹⁶ With that consideration in mind, along with the push for consistency in terms of tax law, the path to cross-border giving should be less arduous.

C. Implementation Issues

The full framework of implementation is beyond the scope of this article, but it is an issue that merits careful attention. Zolt argues that the strongest reason for requiring use of a US charity is “to increase accountability and transparency.”⁹⁷ At the same time, it has been argued that the body responsible for charitable oversight in the UK, the Charity Commission, provides better monitoring than the IRS.⁹⁸ Provided a feasible implementation method can be constructed, revision is necessary if the major global ills of today are to be remedied.

Implementation and oversight issues associated with less priority being afforded to the notion of territoriality in US charitable law raise important concerns. An implementation strategy that takes into account the concern over charitable funds being used to support terrorist activity is crucial. After the tragic events of September 11, 2001, two mechanisms were put into place to ensure charitable funds are not used to promote terrorist activities: (1) Executive Order 13224 and (2) the USA Patriot Act.⁹⁹ The former, among other restrictions, makes it illegal for any US person to engage in a transaction with individuals and organizations named on any terrorism watch lists of the US government.¹⁰⁰ The latter increased the purview of criminal prohibitions related to supporting terrorist

⁹² See Lieber, *supra* note 36, at 741.

⁹³ See Jones, *supra* note 51, at 119 (exploring the restriction on gifts of appreciated property to private foundations in the context of cross-border giving); see also Pozen, *supra* note 9, at 541 (commenting that the emphasis on territoriality combined with the complexity of US cross-border giving rules deters giving to international causes).

⁹⁴ Pozen, *supra* note 9, at 535 (discussing how charitable deduction theories apply to internationally targeted donations).

⁹⁵ See *id.* at 573, 576 (discussing isolationism and universalism in terms of a rationale for the charitable deduction).

⁹⁶ See *id.* at 592.

⁹⁷ Zolt, *supra* note 16, at 392.

⁹⁸ *Id.*

⁹⁹ Janne G. Gallagher, *Grantmaking in an Age of Terrorism: Some Thoughts About Compliance Strategies*, INT’L DATELINE (2004), available at <http://www.cof.org/files/Documents/Newsletters/InternationalDateline/2004/LD2Q2004.pdf>.

¹⁰⁰ *Id.*

activities and strengthened the penalties for noncompliance.¹⁰¹ In addition, it serves as a mechanism to ensure US non-citizen residents who engage in such charitable giving will incur deleterious immigration effects.¹⁰²

I. Looking to Prior Solutions

In addition, in 2002, the Treasury Department released the Anti-Terrorist Financing Guidelines: Voluntary Best Practices for US-Based Charities (“Guidelines”), which as the name suggests, are not compulsory.¹⁰³ These Guidelines were received as “unworkable, marginally related to the diversion of charitable assets, and very likely to discourage international charitable involvement by US organizations.”¹⁰⁴ Two of the most glaring problems with the Guidelines were that they did not consider existing laws applicable to foreign grants or US grantmaker experience with making foreign grants.

The most effective solution in a cross-border context will likely only come from the efforts of US grantmakers who have dealt extensively with foreign charities. In response to the Guidelines, approximately thirty organizations (ranging from private foundations, public charities, and religious organizations to the Council on Foundations and Grantmakers Without Borders) convened a working group to construct “Principles of International Charity” (“the Principles”).¹⁰⁵

Collectively, this group represented thousands of organizations and compiled the Principles after seven months of drafting and an additional year of discussions.¹⁰⁶ The Principles could be applied to any foreign charity eligible to collect deductible donations from US donors.¹⁰⁷ Again, the onus would fall on US donors to show that a given foreign charity satisfies the requirements. Most relevantly for implementation, the Principles provided the following:¹⁰⁸

- Charitable organizations must only carry out the charitable purposes for which they were formed.
- Charitable organizations must meet the charitable law standards of the US and the relevant laws of foreign jurisdictions in which they are carrying out their charitable purposes.
- A charitable organization’s compliance with relevant laws is the province of the board of directors.
- Charitable organizations must ensure that appropriate steps are taken to ensure that their assets are used only for charitable purposes through the use of financial controls.

The Principles are a landmark example of charities collaborating to set up procedural safeguards against the use of charitable assets for terrorist activity. Some

¹⁰¹ *Id.*

¹⁰² 8 U.S.C. §§1182(a)(3) (2012) (authorizing the exclusion of any person who is part of, or represents a, foreign organization or group that endorses acts of terrorism).

¹⁰³ Sharon P. Light, *The Principles of International Charity: An Effective Alternative to the Voluntary Guidelines*, INT’L DATELINE (2005), available at http://www.cof.org/files/Documents/Newsletters/InternationalDateline/2005/legaldimension_Sharonlight.pdf.

¹⁰⁴ *Id.* at 2.

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ It should be noted that certain of the Principles overlap with the requirements of *Persche* as the UK implementation of the case evinces. See *Persche*, *supra* note 6.

¹⁰⁸ See Light, *supra* note 103, at 3.

Treasury Department officials have expressed support for the Principles.¹⁰⁹ In terms of revision of the Principles, the main Treasury Department critique seems to involve the lack of a use of existing “lists of suspected or known supporters of terrorism.”¹¹⁰ An additional requirement regarding use of such lists could easily be added.

Already there have been proposals to place responsibility with US charities for ensuring charitable funds do not end up as terrorist financing.¹¹¹ These same safeguards may be applied to a limited number of foreign charities allowed to receive deductible donations. Even if an alternative implementation strategy based upon the Principles is not approved, applying the Treasury Department’s Guidelines to foreign charities seeking to register with the US would provide another viable option. Although there has been some criticism that the Guidelines shift governmental responsibilities, e.g., the gathering of intelligence, to US charitable organizations, or in the context discussed here, to US donors, they may still provide a framework for securing information about foreign charities that would satisfy possible inquiries about charitable activity abroad involving terrorist financing.¹¹²

2. IRS Approved Lists

In addition to creating US “friends of” organizations, US donors desiring to make donations to foreign charities have used what are known as US donor-advised funds; an observation of proposed regulation of grants from such funds to foreign organizations provides insight regarding implementation. Currently, private foundations make grants to donor-advised funds run by public charities that either have offices or affiliates in various countries, e.g., Give2Asia, United Way International, and Charities Aid Foundation America.¹¹³ A donor-advised fund allows a donor to give up the legal right to select the ultimate recipient of his/her charitable donation but permits such donor to advise the public charity that runs the fund of his/her requested use of the donation.¹¹⁴ For example, a donor may make a donation to a public charity and advise (but not insist) that it be used to fund a specific foreign charitable organization. The IRS may determine that the foreign charities associated with these US public charities meet certain requirements (discussed later), and there is no need for the intermediary. Such foreign charities could also be subject to reporting requirements, akin to those applicable to US charities, once on an IRS approved list. As one commentator has noted, the US charities that are familiar with the target country that is the subject of charitable activity will be the most effective reporters.¹¹⁵ Clearly, it follows that a foreign organization would be able to provide even more salient and accurate information to the IRS.

In 2004, a proposal was made to the Senate Finance Committee to allow US donor-advised funds to make grants only to foreign organizations that are included on the IRS’s

¹⁰⁹ *Id.* at 5.

¹¹⁰ *See id.*

¹¹¹ *See, e.g., id.* at 3.

¹¹² *See id.*

¹¹³ *Donor-Advised Funds and International Grantmaking: Council on Foundations Position on Two Proposals Included in the June 2004 Senate Finance Committee Staff Discussion Draft*, INT’L DATELINE (2004), available at <http://www.cof.org/files/Documents/Newsletters/InternationalDateline/2004/LD4Q2004.pdf>.

¹¹⁴ Timothy R. Lyman & Edgardo Ramos, *Simpler Approaches to Cross-Border Giving through Domestic Collaborations: A Post-September 11 Update*, INT’L DATELINE (2003) (Special Insert), available at <http://www.cof.org/files/Documents/Newsletters/InternationalDateline/ID2ndQuarter03Insert.pdf>.

¹¹⁵ *See* Gallagher, *supra* note 99.

list of approved funds.¹¹⁶ Notably, the Council on Foundations challenged this proposal. The mere fact that it was suggested that the IRS could maintain a list of “approved foreign organizations” suggests that there is a viable option of having the IRS examine at least well-known foreign charities and determine whether they meet certain standards discussed later in the next section.¹¹⁷ Granted, administrative concerns are a factor; however, one must consider that the IRS ultimately would consider far fewer US “friends of” applications and thus have additional time to turn to documentation of foreign organizations, which a donor would be required to submit before securing a deduction. The next section discusses how the European Union has addressed the implementation issue; findings from the ECJ may provide additional insight into a US implementation strategy.

III. EUROPEAN MODEL

A. Persche – The Impetus for Change in the UK & other EU Member States

The current US position on donations to foreign charities is not the only feasible approach as an examination of the laws of the UK and certain other EU member states evinces. Europe offers a model that addresses the above-mentioned implementation issues that the US could emulate. The main impetus for change in the UK (and other EU member states) was a case brought before the ECJ in 2006, *Persche v. Finanzamt Ludenscheid*.¹¹⁸ There have been numerous comments on this decision and various reactions among EU member states. Not every EU member state has decided to amend its laws. The UK is an example of a member state that has taken its time but ultimately embraced the decision. The Netherlands provides an example of one that initially afforded less weight to the notion of territoriality but oddly has refused to conform to *Persche*. Nevertheless, the UK model and the un-revised Dutch model are instructive to the US in considering lessening the weight given to the notion in its charitable laws governing international giving.

In *Persche*, the ECJ launched a dramatic attack against the notion of territoriality as a prevailing concept among the charitable laws of EU member states. *Persche* dealt with a German citizen’s donation of goods (including, *inter alia*, bed linen, towels, and children’s toys) to a Portuguese charitable retirement and children’s home. Germany denied the in-kind donation on the grounds that it was not made to a charity formed in Germany, i.e., based on the notion of territoriality.¹¹⁹ The German tax authorities denied the deduction simply because the home was not formed in Germany. The ECJ held that (i) where a donor claims a tax deduction for a gift made to a non-indigenous charity (“EU charity”), freedom of capital provisions are implicated and (ii) freedom of capital provisions prevent EU member states from legislating that only gifts made to indigenous charities may be deducted without providing an opportunity for a donor to demonstrate that a gift to a EU charity satisfies his/her home State law requirements for a tax deduction.¹²⁰

¹¹⁶ See *Donor-Advised Funds and International Grantmaking*, *supra* note 113.

¹¹⁷ *Id.* (noting that the Treasury Department’s Guidelines have characterized such lists as important tools).

¹¹⁸ See *Persche*, *supra* note 6 (unreported, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62007J0318:EN:HTML>).

¹¹⁹ Even though the case dealt with an in-kind donation, the ECJ made it clear that its ruling applied to cash donations as well. However, if a member state does not provide a tax deduction for goods under its charitable law, the same holds in the context of a donation of goods to a non-indigenous charity. See Philip Simpson, *Tax relief for gifts to European charities* (2009), <http://www.terrafirmachambers.com/articles/TaxReliefForGiftstoEuropeanCharities.pdf>; Income Tax Act, 2007, c. 3, Part 16, § 989 (U.K.).

¹²⁰ See Simpson, *supra* note 119.

In sum, the *Persche* case is a response to the assumption that the notion of territoriality prevents donors from making cross-border donations.¹²¹

A significant case in the area of cross-border charitable giving that the *Persche* court relied upon in its analysis was *Centro di Musicologica Walter Stauffer v. Finanzamt M Nchen fr Krperschaften*¹²². *Stauffer* provides several sound rationales that should be instructive to the US in deciding to comply with *Persche* or to adopt a similar approach in the area of cross-border giving. *Stauffer* dealt with an Italian charity resident in Munich, Germany that funded scholarships for prospective Swiss persons in Bern, Switzerland to study classical musical in Cremona, Italy.¹²³ Specifically, the *Persche* court cited *Stauffer* for the proposition that an EU member state may require a foreign charity to provide information, e.g., annual accounts and activity reports prior to granting such an entity tax exemption.¹²⁴ It also relied upon *Stauffer* to argue that tax benefits associated with a foreign charity carrying out activity in a given member state should not be limited under good policy.¹²⁵ Even though the Italian charity did not directly benefit German citizens, since it also included general education of the history of music as one of its charitable activities, it was deemed to have the possibility of indirectly benefitting Germany and thus Germany's denial of its ability to take in tax deductible donations was seen as improper.¹²⁶

In addition, the *Stauffer* court stated that if Germany had decided to grant tax benefits to German charities carrying out charitable activity, it should not be able to deny the same benefits to Italian ones because, after all, it was free not to extend tax benefits to any charity, whether domestic or foreign.¹²⁷ Since German law did not restrict such benefits to only those German charities that provided a public benefit to its citizens, it could not impose such a restriction upon non-German charities. Although *Persche* has resulted in precedent for curbing the notion of territoriality, and subsequent amendments to the EU Treaty have reflected the same, it still remains the province of the member states to decide whether they will extend tax benefits to each of the EU member states.

The solution *Persche* proposes for EU member states involves a two-part inquiry. The first question is whether the EU charity would be recognized as charitable under the law of the Member State in which it is formed.¹²⁸ The second question is whether it would be recognized as such under the donor's home state charitable law.¹²⁹ To summarize, a donor would be able to receive a tax deduction for a gift made to an EU charity if, and only if, such a charity would be recognized as one under the law of the state in which the deduction is sought and under the charitable law associated with the home state where it was formed.¹³⁰ Regarding the second prong, although there has been some debate about

¹²¹ *Id.*; see also Case C-318/07, *Hein Persche v. Finanzamt Ludenscheid*, 2009 E.C.R. I-359, paras. 47, 38.

¹²² Case C-386/04, *Centro di Musicologia*, 2006 E.C.R. I-8203.

¹²³ See *id.* at para. 9; see also Charles R. Ostertag, *We're Starting to Share Well with Others: Cross-Border Giving Lessons from the Court of Justice of the European Union*, 20 TUL. J. INT'L & COMP. L. 255, 269 (2011).

¹²⁴ See Ostertag, *supra* note 123, at 265.

¹²⁵ *Id.* at 268.

¹²⁶ See Case C-386/04, *Centro di Musicologia*, 2006 E.C.R. I-8203.

¹²⁷ See Case C-318/07, *Persche*, 2009 E.C.R. I-359, para. 44.

¹²⁸ *Id.* at paras. 49, 63; see also Simpson, *supra* note 119.

¹²⁹ Case C-318/07, *Persche*, 2009 E.C.R. I-359.

¹³⁰ *Id.*

whether the standard the foreign charity must meet is “likely,” the ECJ’s decision expresses that the test is absolute.¹³¹

Interestingly, the ruling does not mean that donations of goods or other non-cash assets to a foreign charity would result in an income tax deduction where the donor’s home state legislation does not allow for a deduction in such instances.¹³² Moreover, the decision does not apply to donations of services (since such services do not fall within the ambit of free movement of capital under Article 56 of the European Community (“EC”) Treaty).¹³³ At the same time, it could be argued that a donation of services, which does not result in a deduction under US law, implicates freedom to provide services under Article 49 of the EC Treaty.¹³⁴

Another issue of contention has been that of evidence which, according to the *Persche* case, the donor’s home state may require him/her to bear.¹³⁵ (As stated earlier, this would prove most administrable in terms of US implementation as well.) In other words, the donor’s home state may demand that he/she offer evidence to show that the foreign charity satisfies the requirements of the *Persche* test.¹³⁶ To establish the charitable status of an EU charity under the relevant member state law and the donor’s home state law, a donor may be required to provide, *inter alia*, the following: “a certificate of establishment, its constitution, annual reports and accounts, and any certificate of charitable status issued by its own member state.”¹³⁷ Where a donor has provided insufficient evidence to make such a showing, the ECJ determined that it is up to each home state to decide the adequacy of information, submitted on a case-by-case basis, and whether the home state should send a request to the charity’s member state under the “tax information exchange directive” (“Directive”).¹³⁸ Thus, the donor’s home state may deny a tax deduction but should take into account the extent to which the taxpayer has attempted to secure the required information. If it appears the donor’s efforts were adequate, such home state should use the procedures set forth in the Directive to secure the missing information prior to denying a deduction.¹³⁹

Using the UK as an example, a UK donor should request all relevant evidence from the EU charity and provide it to Her Majesty’s Revenue and Customs (“HMRC”), along with a copy of his or her request, at the time of seeking a deduction. HMRC would make a determination of whether the information was adequate, and if not, whether the taxpayer made a diligent effort to obtain all necessary information. If such an effort is found, HMRC would ask the charity’s member state for assistance with obtaining additional information under the Directive. If HMRC still does not have adequate information, it may refuse the donor’s request for a deduction. The UK’s current rules reflect this framework in a more detailed manner as described in the next section.

The ECJ could have more strongly attacked the notion of territoriality. It only answered the German court that a donor must be provided with the opportunity to show

¹³¹ *Id.*

¹³² *Id.*

¹³³ See Simpson, *supra* note 119.

¹³⁴ See *id.*

¹³⁵ Case C-318/07, *Persche*, 2009 E.C.R. I-359, para. 54ff.

¹³⁶ *Id.*

¹³⁷ See Simpson, *supra* note 119.

¹³⁸ *Id.*

¹³⁹ *Id.*

evidence that his or her gift qualifies for a tax deduction.¹⁴⁰ It did not define what type of opportunity must be granted.¹⁴¹

In contrast, an issue does remain regarding whether the donor's home state must deem sufficient a declaration by a charity formed in another member state that it is charitable under the donor's home state's charitable law.¹⁴² In the case of the UK, for example, if HMRC may rely only on a declaration of an EU charity, suspicions will inevitably result.¹⁴³ Fortunately, the requirement that such an EU charity also show that it meets the definition of a charity under UK law now circumvents the problem of placing sole weight on a declaration.¹⁴⁴

Another issue that the ECJ does not cover in *Persche* is whether a donation made to the branch or agency of a charity "established" in a member state still entitles the donor to a tax deduction.¹⁴⁵ An "establishment" includes branches and agencies.¹⁴⁶ European law allows a charity incorporated outside the EU to qualify as a branch or agent.¹⁴⁷ In contrast, "established" in terms of US charitable law means "created in or organized under the laws of the US."¹⁴⁸ If a charity has been incorporated outside the EU and has a branch or agency in the EU that has been recognized as charitable, a deduction to such branch or agency may result in a tax deduction.¹⁴⁹ Some have posited that the *Persche* decision prevents the result of having a charity formed in a non-EU member state collect tax-deductible donations through an EU member branch or agency by including the Directive.¹⁵⁰ Arguably, since such third party countries would not be subject to the Directive, donations to their branches or agencies would not be tax deductible.¹⁵¹

B. Drawbacks of *Persche*

In terms of a UK donor, there will be some inconvenience given that the declaration required from the EU charity may not be readily available.¹⁵² It is common for UK charities to have a gift aid declaration form (explained below) that is provided to donors to ensure them that their donation will result in a UK tax deduction.¹⁵³ Under EU law, if a requirement renders the obtaining of a tax deduction "virtually impossible or excessively difficult," it may be held unlawful; however, it is clear that the declaration requirement would not fall into either of these categories.¹⁵⁴

In terms of practicalities, the ECJ did not find that the difficulties posed by a requirement of providing sufficient information that an EU charity in fact was established

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

¹⁴² *Id.*

¹⁴³ *Id.*

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*; consolidated version of the Treaty on the Functioning of the European Union, art. 49, October 10, 2012, 2012/C 326/47, available at <http://www.refworld.org/docid/52303e8d4.html>.

¹⁴⁷ See Simpson, *supra* note 119.

¹⁴⁸ I.R.C. § 170(c)(2) (2012).

¹⁴⁹ See Simpson, *supra* note 119.

¹⁵⁰ See *id.*

¹⁵¹ Case C-318/07, *Persche*, 2009 E.C.R. I-359, para. 70.

¹⁵² See Simpson, *supra* note 119.

¹⁵³ *Id.*

¹⁵⁴ *Id.*

and operated as a charity justified retaining the notion of territoriality (which, as stated earlier, was deemed to be in clear violation of freedom of movement of capital).¹⁵⁵ One UK practitioner noted that after *Persche*, an EU charity could be required to submit documents (with English translations) showing the following: its home state has recognized it as charitable; it has carried out relevant purposes; and it would be a charity if formed under UK law.¹⁵⁶ Interestingly, that is exactly what the UK has decided to adopt.¹⁵⁷

The overall effect of *Persche* on UK cross-border giving is complicated by the UK's proposed adoption (and subsequent abandonment) of a cap on charitable giving in the wake of implementation.¹⁵⁸ At the same time, it is clear that a small number of wealthy donors have used off-shore, i.e., non-UK, charities for personal gain.¹⁵⁹ However, tax authorities largely view this behavior as easily recognizable, which suggests abuse is not rampant.¹⁶⁰ The European Foundation Center and Transnational Giving Europe are presently collaborating on a report that will trace the major developments in EU charitable giving since *Persche*.¹⁶¹ The report is scheduled for release during the later portion of 2013.¹⁶² The findings, along with recent questioning of the IRS's ability to monitor charities,¹⁶³ will be examined in the context of the second article in this series as instructive guidance for an implementation framework for the US.

I.V. UK MODEL - NEW NOTIONS IN LIGHT OF PERSCHE

The UK provides an example of a country that recently has abandoned the notion of territoriality to a large extent in terms of granting tax deductions for donations to certain foreign charities, and this example may be instructive to the US. As explained, the main reason for the UK's near abandonment of the notion was *Persche*. After considering the history of the notion of territoriality in UK laws, an examination of the UK's current charitable law in regard to cross-border giving (in light of *Persche*) will be discussed.

A. UK - History of Territoriality

The notion of territoriality was firmly affixed in UK charitable law in 1956 in the decision of *Camille and Henry Dreyfus Foundation, Inc. v. Inland Revenue*

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ See *Chapter 2 - Applications for recognition as a charity for tax purposes*, HM REVENUE & CUSTOMS, http://www.hmrc.gov.uk/charities/guidance-notes/chapter2/chapter_2.htm (last visited Nov. 10, 2013).

¹⁵⁸ Tania Mason, *Tax Relief Cap is Motivated by Persche Ruling, say Lawyers*, CIV. SOC'Y FIN., April 2, 2012, available at http://www.civilsociety.co.uk/finance/news/content/12047/tax_relief_cap_is_motivated_by_persche_ruling_say_lawyers/society; see also *Tax relief limit on charity to be axed in fresh U-turn*, BBC NEWS, May 31, 2012, 11:49 AM, <http://www.bbc.co.uk/news/uk-politics-18278253>.

¹⁵⁹ Kiran Stacy, *How the Offshore Charity Tax Scam Works*, FIN. TIMES WESTMINSTER BLOG, April 11, 2012, 7:20 PM, <http://blogs.ft.com/westminster/2012/04/how-the-offshore-charity-tax-scam-works/>.

¹⁶⁰ See *id.*

¹⁶¹ European Foundation Center, *European Foundation Center 2012 Annual Report and Financial Statement*, http://www.efc.be/programmes_services/resources/Documents/EFC-7876%20Annual%20Report%202012%20AB%20V8.pdf (last visited Nov. 11, 2013).

¹⁶² See *id.*

¹⁶³ Gary D. Bass and Elizabeth J. Kingsley, *Scandal Should Prompt IRS to Clarify Rules*, THE CHRONICLE OF PHILANTHROPY, May 15, 2013, <http://philanthropy.com/article/Scandal-Should-Prompt-IRS-to/139265/>.

Commissioners.¹⁶⁴ This case dealt with section 37(1)(b) of the Income Tax Act of 1918. Thus, charitable donations were only subject to tax relief (most notably, tax deductions) when they were made to a charity formed in the UK.¹⁶⁵ In other words, for purposes of income tax, capital gains tax, and the UK's equivalent of the US estate tax ("inheritance tax"), the term "charities" refers to only those formed in the UK.¹⁶⁶ Although capital gains tax legislation does not expressly include the notion, HMRC has applied the notion in both the income tax and capital gains tax contexts.¹⁶⁷ In terms of legislation regarding inheritance tax, HMRC has applied the case-law meaning of "charity."¹⁶⁸ In sum, the UK's adoption of the notion of territoriality means that historically donations made to charities formed in other EU member states ("EU charities") and to US charities have not resulted in tax deductions.

Perhaps the most striking objection to the adoption of the notion of territoriality in the UK was that it conflicted with European law.¹⁶⁹ Well-regarded UK tax practitioners and scholars, Kessler and Kamal, have noted this tension.¹⁷⁰ In addressing this issue in 2006, the European Commission informed the UK about the unfair results arising from its embrace of the notion of territoriality.¹⁷¹ Specifically, the European Commission sent an opinion to the UK prior to *Persche*.¹⁷² Although the change was not sudden, the UK has amended its law since the European Commission clarified and emphasized its position in *Persche*.¹⁷³

B. Current UK Law

The US may benefit from an understanding of how the *Persche* case informed a change in the UK in considering whether to move away from the notion of territoriality. The *Persche* decision takes opposition with the argument in the UK that UK and EU charities are not comparable because different charitable tests of benevolence apply.¹⁷⁴ The test adopted in *Persche* would require that a foreign charity meet the requirements of a UK charity before a donation to it would result in a tax deduction.¹⁷⁵

The UK made a dramatic stride in weakening the grip of the notion of territoriality by adopting a new definition of charity under the Finance Act 2010 ("the Finance Act") that results in applying UK tax reliefs to certain charities and other organizations ("charities") in the EU, Norway, and Iceland ("European charities"), specifically those that are determined to be equivalent to UK charities (or Community Amateur Sports Clubs).¹⁷⁶ To be eligible to take in deductible donations, these charities must meet the new definition of charity under the Finance Act, which includes the following requirements, as explained in more detail and in their statutory context in the next section:

¹⁶⁴ [1956] 1 A.C. 39.

¹⁶⁵ See Simpson, *supra* note 119.

¹⁶⁶ *Id.*

¹⁶⁷ *Id.*

¹⁶⁸ *Id.*

¹⁶⁹ *Id.*

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.*

¹⁷³ See Chapter 2 - Applications for recognition as a charity for tax purposes, *supra* note 157.

¹⁷⁴ See Simpson, *supra* note 119.

¹⁷⁵ *Id.*

¹⁷⁶ Finance Act, 2010, c. 13 (U.K.).

- (1) Be able to show that if they were based in the UK, they would be considered a charity, *i.e.*, have a charitable purpose under the Charities Act of 2011;
- (2) Be formed in an EU Member State, Iceland, or Norway;
- (3) Be registered by the equivalent of the tax charity regulator (*i.e.*, the equivalent of the UK's "Charity Commission") if required under its country's laws; and
- (4) Be managed by "fit and proper persons."¹⁷⁷

Under Schedule 6 of the Finance Act, "charity"¹⁷⁸ means "a body of persons or trust that—(a) is established for charitable purposes only, (b) meets the jurisdiction condition (see paragraph 2), (c) meets the registration condition (see paragraph 3), and (d) meets the management condition (see paragraph 4)."¹⁷⁹ Given an examination of (a) and (b) above, it is clear the notion of territoriality now plays less of a role in terms of what constitutes a charity. Under the Finance Act of 2010, a non-UK charity may also be considered to have been "established for a charitable purpose" provided its purpose meets the definition set forth in the most recent Charities Act, which currently is the Charities Act of 2011.¹⁸⁰ (Also, the charity must be required under its "governing document to us[e] all of its income and assets for its stated charitable purposes.")¹⁸¹

However, there is still a jurisdictional (albeit much less restrictive) overlay provided with paragraph 2. Paragraph 2(1) provides the following:

A body of persons or trust meets the jurisdiction condition if it [is] subject to the control of—(a) a relevant UK court in the exercise of its jurisdiction with respect to charities, or (b) any other court in the exercise of a corresponding jurisdiction under the law of a relevant territory.¹⁸²

As a result, under 2(b), the UK charitable law has decreased the role of the notion of territoriality but has not abandoned it, and therefore, it strikes an acceptable balance. If a non-UK charity is subject to the courts of certain "relevant territories," defined in subparagraph 3 as "(a) a member State other than the United Kingdom, or (b) a territory specified in regulations made by the Commissioners for Her Majesty's Revenue and Customs,"¹⁸³ it may take in tax deductible donations. Norway and Iceland were added to the list of "relevant territories" in paragraph 2(3) by related regulations.¹⁸⁴ As HMRC notes on its site, the jurisdiction condition is satisfied by a European charity when it is subject to the control of a court with a jurisdiction corresponding to that required for UK charities, *i.e.*, for purposes of the UK High Court, the Court of Session in Scotland, or the High Court in Northern Ireland.¹⁸⁵

¹⁷⁷ See *Chapter 2 - Applications for recognition as a charity for tax purposes*, *supra* note 157.

¹⁷⁸ There have been further changes regarding the definition of charity for purpose of charities that do not collect gift aid, which are not the focus of this article.

¹⁷⁹ Finance Act, 2010, c. 13, § 1, sch. 6 (U.K.).

¹⁸⁰ *Id.* ("For the meaning of "charitable purpose," see section 2 of the Charities Act [2011], which—(a) applies regardless of where the body of persons or trust in question is established, and (b) for this purpose forms part of the law of each part of the United Kingdom . . ."). See Charities Act 2011, c. 25, § 2 (U.K.).

¹⁸¹ *Chapter 2 - Applications for recognition as a charity for tax purposes*, *supra* note 157, at § 2.4.

¹⁸² Finance Act, 2010, c. 13, § 1, sch. 6 (U.K.).

¹⁸³ See Finance Act, 2010, c. 13, § 2, sch. 6 (U.K.).

¹⁸⁴ See Explanatory note to the Finance Act, 2010, c. 13, sch. 6 (U.K.),

<http://www.legislation.gov.uk/uksi/2010/1904/note/made>.

¹⁸⁵ See *Chapter 2 - Applications for recognition as a charity for tax purposes*, *supra* note 157.

In terms of the last two requirements, a European charity meets the “registration condition” if under the law of the country where it is established (“home State”), it is required to be registered, and it is so registered.¹⁸⁶ The “management condition” may be met through satisfaction of the “fit and proper persons” test by those who have control and management of the charity.¹⁸⁷ At the same time that the UK has embraced a broader concept of charity that includes certain foreign charities, interestingly, as noted earlier, it has toyed with the idea of adopting an income tax relief cap that affects both charitable deductions and on-charitable deductions.¹⁸⁸ UK citizens have successfully avoided that result.¹⁸⁹

C. If the UK Did it, the US Should

The nature of how charitable donations result in a tax deduction for donors, and uniquely an additional amount for the charity by the UK taxing authority (HMRC) underscores the viability for a similar result in terms of the US. If the UK, with its more complex mechanisms for handling tax relief was able to change its laws for the greater good, the US should be able to do the same. An examination of the complexities of the UK’s implementation issues, which do not apply to and thus strengthen the argument in favor for US implementation, follows.

In the UK, for a donation to entitle a donor to income tax relief, it must be cash and be made to a charity “established for charitable purposes.”¹⁹⁰ Under the UK’s revised law, a foreign charity may be deemed so “established.” Tax relief is available for gifts of shares, securities, and land;¹⁹¹ however, this article is concerned with income tax relief available and therefore the analysis will be confined to cash donations. When a donor in the UK makes a donation, the “Gift Aid” provisions result in tax relief in a manner that differs from that used in the US and that adds a few extra levels of complexity. First, donors are deemed to have given an additional amount equal to the amount of “basic rate” tax on the gift.¹⁹² In other words, HMRC assumes that the donor meant to give the donated amount, plus any basic rate income tax that was paid on the amount. The recipient charity reclaims this amount from HMRC.¹⁹³ “Higher rate taxpayers,” 40% rate taxpayers, are entitled to a tax deduction on their gift (“UK tax deduction.”).¹⁹⁴ For the April 2013 tax year, the higher rate taxpayer threshold has been reduced from £42,475 to £41,450.¹⁹⁵

The UK tax relief system poses a number of complications and arguments against a leaning away from the notion of territoriality, which fortunately the US system does not embody. HMRC requires that gift aid declarations include a statement that the donor has paid enough income and capital gains tax to cover the basic rate of tax on the gift which is

¹⁸⁶ *See id.*

¹⁸⁷ *Id.* The fit and proper persons test will be discussed more fully in Part II.

¹⁸⁸ *See Tax Relief Limit on Charity to be Axed in Fresh U-Turn*, BBC NEWS, May 31, 2012, 11:49 AM, available at <http://www.bbc.co.uk/news/uk-politics-18278253>.

¹⁸⁹ *Id.*

¹⁹⁰ *See Simpson, supra* note 119, at 1.

¹⁹¹ *Gifts to charity of land, buildings or shares by individuals*, HM REVENUE & CUSTOMS, <http://www.hmrc.gov.uk/individuals/giving/assets.htm> (last visited Nov. 11, 2013).

¹⁹² *Giving to Charity Through Gift Aid*, HM REVENUE & CUSTOMS, <http://www.hmrc.gov.uk/individuals/giving/gift-aid.htm> (last visited Nov. 11, 2013).

¹⁹³ *Id.*

¹⁹⁴ *Id.*

¹⁹⁵ *Budget 2012: More to Pay Higher-Rate Tax, says IFS*, BBC NEWS, Mar. 22, 2012, 6:04 PM, available at <http://www.bbc.co.uk/news/business-17475709>.

grossed up.¹⁹⁶ Arguably, donors may not be aware of such a requirement when dealing with an EU charity and not make this requisite representation associated with Gift Aid Declarations to HMRC. As a result, donors to an EU charity would probably need to make a separate Gift Aid declaration, stating that they had paid the requisite amount of income tax to HMRC. The way Gift Aid functions (with HMRC paying an additional amount to the charity in question) may cause some administrative burdens and complications with currency exchanges, but as one practitioner has noted, and the UK tax authorities subsequently agreed, these are not insurmountable obstacles.¹⁹⁷ Even if one thinks HMRC should not be required to pay over the gross up amount to a foreign charity, it should be a foregone conclusion that the donor in this instance is entitled to a tax deduction although that was more than likely a topic of debate.¹⁹⁸ Also, it is worth noting that there will be numerous times when a foreign charity will not know to claim an additional amount from HMRC, which will result in a windfall for HMRC.¹⁹⁹ As one practitioner has noted, that a foreign charity must apply to HMRC to obtain the additional amount owed, will ensure that the administrative burden on HMRC is kept at a level similar to that for UK formed charities.²⁰⁰

Given that the UK ultimately decided to embrace the approach of *Persche* and allow tax-deductible donations to be made to foreign charities, it is entirely feasible for the US to do the same. The UK system is vastly more complex in terms of providing relief in this area, yet it still managed to adapt to this change and to design an effective means of implementation. The US system would not have as many administrative costs associated with implementation or pose as great of a burden on donors.

V. THE NETHERLANDS – STARTING EARLY BUT FINISHING LATE IN THE CROSS-BORDER GAME

A. Current Law in the Netherlands

The Netherlands' charitable law began to turn away from the notion of territoriality early in the 20th century. However, the Netherlands has lagged behind other EU member states in making the leap required under *Persche*. Since the notion of territoriality has been embodied in its charitable laws, an examination is warranted in considering a possible change for the US.

Much like for a US donor, in order for a Dutch resident donor to receive an income tax deduction, his/her contribution must be made to a resident philanthropic organization (“a Dutch charity”) as defined in Art. 6.33 of the Income Tax Act (“ITA”).²⁰¹ The notion of territoriality has been firmly established in the definition of a Dutch charity since the term was formulated.²⁰² The definition of a Dutch charity was originally provided for in

¹⁹⁶ See *Giving to Charity Through Gift Aid*, *supra* note 192.

¹⁹⁷ See Simpson, *supra* note 119.

¹⁹⁸ *Id.*

¹⁹⁹ *Id.*

²⁰⁰ *Id.*

²⁰¹ *Inkomstenbelasting*, Stb. 2001 6115, art. 6.33; See also Ineke A. Koele, INTERNATIONAL TAXATION OF PHILANTHROPY: REMOVING TAX OBSTACLES FOR INTERNATIONAL CHARITIES 233 (2007) (noting that the categorization of a “public benefit organization” also known as a philanthropic organization is relevant for income tax purposes as well as gift and inheritance tax purposes). For purposes of this article, a Dutch “public benefit organization” will be referred to as a charity, and the income tax implications of such status to individual Dutch resident donors will be addressed.

²⁰² See Koele, *supra* note 201, at 267 n.116.

the Gift and Inheritance Tax Act of 1956. It is defined as “an organization resident in the Netherlands or in the overseas territories of the Netherlands, the pursuits of which [are] addressed to the Dutch territory.”²⁰³ The requirement that the charitable purpose be carried out in the Netherlands was later abandoned²⁰⁴ resulting in a closer similarity to the law in the US and the UK. As Dutch charity expert Ineke Koele points out, Dutch resident donors typically do not receive deductions for donations to non-Dutch charities.²⁰⁵

The reason that has been evidenced in the Netherlands regarding the existence of the notion of territoriality is “the need for effective control regarding the operational test of the recipient organization.”²⁰⁶ In order to be considered formed in the Netherlands, the organization must be incorporated under Dutch civil law and meet associated procedural requirements (e.g., notarial deed). However, if the charity is managed outside of the Netherlands, it will not be considered a Dutch charity and therefore cannot take in deductible donations from Dutch resident donors.²⁰⁷

It is important to note a distinction between types of gifts under Dutch charitable law. The ITA addresses two categories of gifts: (1) one-time gifts and (2) “periodic gifts.”²⁰⁸ For purposes of this article, the former will be addressed.²⁰⁹ A one-time gift is deductible to the extent it (aggregated with other gifts by the donor) exceeds a minimum threshold (1% of taxable gross income) and the total one-time gifts of the donor does not exceed a maximum threshold (10% of taxable gross income before personal deductions).²¹⁰

Unfortunately, the same inefficiencies discussed in regard to the US, and formerly the UK, result in the Netherlands because of its territoriality system. A non-resident founder must form a Dutch charity even if the charitable activity proposed is carried out completely outside of the Netherlands.²¹¹ If it is discovered that a Dutch charity is supporting violence or if it subverts Dutch public policies, it will no longer be considered to meet the definition of charity provided for in the ITA.²¹²

B. Request for Change

Although the Netherlands’ system for determining when to allow Dutch donors’ donations to foreign organizations to result in a tax deduction is likely to change given the EU Commission’s requests in light of *Persche*, its current system, which already affords less primacy to the notion of territoriality, may prove instructive for determining a system of compliance and enforcement that may be useful for the US. From 1990, the ITA and the Corporate Income Tax Act (“CITA”) have given the Ministry of Finance the authority

²⁰³ *Id.*

²⁰⁴ *Id.* (commenting that the domestic use requirement was eliminated when the law was conformed “to the new *Belastingregeling voor het Koninkrijk*,” a separate Convention with other countries). *See also* Koele, *supra* note 201, at 267–68 (discussing a 1983 Supreme Court decision upholding the deductibility of a donation made to the Liberation Fund Southern Africa and the Chili Committee Nederland even in the absence of a goal to further a charitable purpose in the Netherlands).

²⁰⁵ *Id.* at 268.

²⁰⁶ *Id.*

²⁰⁷ *Id.*

²⁰⁸ *Id.* at 233.

²⁰⁹ As Koele points out, “It is . . . possible for Dutch resident individuals to give away their entire taxable income through the mechanism of a periodic gift, as no limits apply.” *Id.*, at 234.

²¹⁰ *See* Stb. 2001 6115, arts. 6.35, 6.39.

²¹¹ *See* Koele, *supra* note 201, at 268.

²¹² *Id.*

to name foreign qualifying charities as able to receive tax deductible donations from Dutch residents.²¹³ Essentially, there are three types of foreign qualifying charities under the Dutch regime, those which (1) increase their reach and charitable activity to the Netherlands and meet the requirements of a Dutch charity (e.g., European political parties), (2) increase their reach and charitable activity not just to the Netherlands but globally (e.g., environmental charities), and (3) carry out a charitable purpose in their home country that a Dutch charity does but only if the donor resides there (and is considered a Dutch resident by one of two specified standards).²¹⁴ Depending upon which category the foreign charity falls into from above, the information it is required to submit to Dutch tax authorities will vary. In both scenarios (1) and (2), the foreign charity must offer evidence that allows the Dutch tax authorities to assess its charitable nature and a sufficient connection to the Netherlands. However, in scenario (2), the foreign charity must submit the following additional information: (1) a declaration from its home state tax authorities, (2) organizational documents, (3) a description of its charitable activities; and (4) yearly spending and income.²¹⁵ If the foreign charity has a Dutch establishment, it will not be considered “qualifying.”²¹⁶ “Foreign Affairs” taxing authorities determine whether a foreign charity is “qualifying.” This body maintains a list that is regularly published, and as of the date of Koele’s book, there were around 22 foreign charities listed, most of which are well-known: UNHCR, INSEAD, etc.²¹⁷

The reason advanced in Dutch parliament for only allowing a limited exception to the notion of territoriality, where the charitable purpose either directly involves the Netherlands as in scenario (1) or indirectly as in scenario (2), is that it would be too difficult to determine whether the operational test was met if there were no requirement of a Dutch connection.²¹⁸ The parliament determined that foreign charities without a tie to the Netherlands would be too difficult to monitor.²¹⁹ As Koele points out, “[I]t can be said that the Dutch policy is aimed at a narrow and discretionary resolution of the landlock in situations where the Dutch public interest is (partly) directly or indirectly served by the activities of a foreign philanthropic organization; the argument of a lack of control is apparently overcome in these situations.”²²⁰ This thinking is evident in the requirement that foreign charities with an indirect Dutch purpose must provide “more information to Dutch tax authorities.”²²¹

C. Historical Reasons for the Notion in the Netherlands

The history of the limited exception to the notion of territoriality is insightful. The extension of the ability to take in deductible donations to certain foreign charities in 1990 sparked debate between parliamentary members and the Secretary of State.²²² Some of the former argued that the extension should not be granted to foreign charities that do not have

²¹³ *Id.* at 269.

²¹⁴ *Id.* (explaining in the third scenario that the foreign charity does not have to be deemed a qualifying foreign charity).

²¹⁵ *Id.*

²¹⁶ *Id.*

²¹⁷ *See id.* at 270.

²¹⁸ *Id.*

²¹⁹ *Id.*

²²⁰ *See id.* at 270–71.

²²¹ *Id.* at 270.

²²² *Id.*

Dutch-specific interests.²²³ However, the Secretary of State noted that Dutch charities that carry out their charitable activity wholly abroad may still receive tax deductible donations under existing law: “[I]t is not required that a deductible gift indirectly serve a Dutch purpose, as under current law, gifts to domestic philanthropic organizations may be used by the latter for entirely foreign causes.”²²⁴ The Secretary of State also addressed the Dutch position in the context of larger European Union views about cross-border giving and noted that generally gifts to foreign charities are not eligible for a tax deduction in the home State of the donor, but did not address whether this was a violation of the EC Treaty, which of course the ECJ later decided it was in *Persche*.²²⁵ In 2006, a bill was introduced that would allow for a greater expansion to the number of foreign charities that would be able to receive tax-deductible donations from Dutch resident donors.²²⁶ The motivation for this change was that the Dutch government did not think the rationale advanced for treating foreign charities differently would be acceptable to a challenge of a violation of freedom of movement of capital as was held in *Persche*.²²⁷ As explained below, this was an insufficient step.

D. Falling Behind the Giving Times

Unfortunately, the Netherlands has fallen behind in terms of opening up its borders in light of *Persche*. In 2011, the European Commission decided to bring the Netherlands before the ECJ after it failed to offer Dutch donors a chance to submit evidence that a donation to a foreign charity qualifies for a deduction, which now is a violation of the EU restriction against impeding free movement of capital after *Persche*.²²⁸ As explained above, Dutch tax deductions are available only for charities that are registered in the Netherlands.²²⁹ While foreign charities may be registered, the registration requirement discourages Dutch donors from making gifts to foreign charities and does not provide them with an opportunity to show that the gift to a non-registered foreign charity is deductible as required under *Persche*.²³⁰

As it currently stands, the Dutch charitable law on this point violates EU rules on the free movement of capital under Article 63 of the EU and Article 40 of the European Economic Agreement.²³¹ The Netherlands is not alone in terms of being brought before the court. There is also an infringement case against France regarding foreign charities.²³²

VI. WAKE AFTER PERSCHE WITHIN THE EU

Most EU member states have revised their charitable laws in light of *Persche* to allow tax-deductible donations to be made to either domestic charities or to those formed

²²³ *Id.*

²²⁴ *Id.* (citing *Memorie van Antwoord*, 21335, 1989-1990, TK, no. 5, V-N 1990/764).

²²⁵ *Id.*; Case C-318/07, *Persche*, 2009 E.C.R. I-359, paras. 39.

²²⁶ See Koehle, *supra* note 201, at 271 (referencing Art. 6.33(1)(b) of the amended ITA after entry into force)

²²⁷ See *id.* at 271-72.

²²⁸ *Taxation: Commission refers The Netherlands to Court over tax discrimination against foreign charities*, EUROPA, Apr. 6, 2011, available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/429> (citing § 60 of Case C-318/07, *Persche*, 2009 E.C.R. I-359).

²²⁹ *Taxation: Commission refers The Netherlands to Court over tax discrimination against foreign charities*, EUROPA, Apr. 6, 2011, available at <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/429>.

²³⁰ *Id.*

²³¹ *Id.*

²³² *Id.*

within other EU member states.²³³ Sweden still does not extend this tax benefit to any charity.²³⁴ It was not a foregone conclusion that the member states had to adopt this change. The main challenge for countries choosing to loosen the grip of the notion of territoriality, as one may imagine, is how to determine whether a foreign charity is equivalent enough to a domestic one.²³⁵ Although conformity with the ruling has resulted in additional cost and burden to donors, the ECJ has pre-empted complaints by noting both were only fair if such donors wanted the benefit of a tax deduction or alternatively, the foreign charities could absorb such costs.²³⁶ Germany has decided that a foreign charity that has a public benefit activity outside of Germany must show that such activity supports German permanent residents or benefits Germany's reputation.²³⁷ In so choosing, Germany has taken the exit door that the *Persche* court and *Stauffer* court provided.²³⁸ This type of territoriality is one permitted under both courts since it does not involve discrimination between foreign and German charities.²³⁹ Under Germany's new law, the taxpayer in *Persche* would lose.²⁴⁰ Germany's approach seeks to yield to lost tax base only when German public interest is fostered.²⁴¹ In effect, Germany is seeking to assure it will receive in public benefit what it has lost in terms of tax revenue by granting a deduction.

CONCLUSION

HOW *PERSCHE* SHOULD AFFECT CROSS-BORDER GIVING IN THE US

The current US charitable law regarding the deductibility of donations to foreign charities violates *Persche* through over-reliance and emphasis on the notion of territoriality. Under *Persche*, if a US donor made a donation to a foreign charity and provided the IRS with written evidence that the foreign charity was equivalent to a US charity, he/she should be able to receive a tax deduction in the US.²⁴² The mechanics of compliance and prevention of terrorist funding are merited concerns, which will be addressed fully in Part II of this series. Assuming both may be met satisfactorily, there is no reason for the US not to adopt *Persche*.

The US has entered into the bilateral treaties mentioned earlier which effectively provide the same extension of benefits set forth in *Persche* to the three relevant countries.²⁴³ One may note that it seems strange that the US would be willing to extend tax benefits to a US charity that conducts all of its charitable activity abroad but not to a foreign charity that may/may not benefit its own citizens.²⁴⁴ In Dutch law (and now in Germany's opposition to extending such benefits to foreign charities that do not benefit its residents or reputation), one perceives a type of logic that sees the exchange as an economic tradeoff.²⁴⁵ The US's position should be revised or modified to provide some consistency.

²³³ See Ostertag, *supra* note 123, at 270.

²³⁴ *Id.*

²³⁵ *Id.*

²³⁶ See *id.* at 271

²³⁷ *Id.*

²³⁸ *Id.*

²³⁹ See *id.*

²⁴⁰ *Id.*

²⁴¹ *Id.*

²⁴² See *id.* at 272

²⁴³ See *id.* at 274.

²⁴⁴ *Id.*

²⁴⁵ See *id.* at 271–72; see also *supra* note 201 and accompanying text.

Regardless of the US theory of what a charitable deduction is, it is clear that not allowing even a prescribed set of foreign charities, i.e., as the Netherlands does, to take in tax deductible donations while extending that ability to US charities conducting their entire charitable activity outside of its borders, is inconsistent. The US has already abandoned its firm adherence to the notion of territoriality as recently as 2010. The US loosened the tie of the notion of territoriality in certain emergency situations, notably after the Haiti and Chile earthquakes during that year.²⁴⁶ In regard to possible terrorist concerns, which will be discussed in Part II of this series along with implementation, at least one scholar has noted that the US would improve its reputation and deter such activity by taking steps in the philanthropic context that would promote a positive conception in the global community.²⁴⁷ As Simon, Chisolm, and Dale have stated, “Congress has never provided a satisfactory explanation for a rule that, at least on gross examination, has an isolationist scent and that is, on the other hand, easily bypassed.”²⁴⁸ A decision to extend tax benefits along the lines of *Persche* through appropriate means would be crucial to improving the image of the US and to ensuring the European Union does not consider its efforts to be taken in vain.

The US sets the tone in terms of quantitative giving, and it is likely that other countries are looking to its policies in determining their qualitative response to *Persche*. In terms of monitoring, the presence of a US address and perhaps a few board members does little to regulate charitable activity that is carried out solely in another country.²⁴⁹ Instead, the US could look to whether the foreign charity is benefitting the US either directly or indirectly (e.g., because it is addressing a global concern) similar to the (soon to be modified) Dutch and German approach. In an even better move to advance global philanthropy, the US should consider adopting the approach advanced in *Persche*, i.e., allowing a US donor that shows a donation was made to the substantial equivalent of a US charity to receive a tax deduction upon submission of proper evidence.²⁵⁰ Finally, what about the voice of philanthropic American people? Arguably, most US donors would want deductions for donations made to foreign charities that are addressing global problems or attempting to assist the US. The US is a leader in terms of innovation and compassionate upholding of global justice. US laws in regard to cross-border charitable giving should reflect its distinct position and policies.

²⁴⁶ See *id.* at 275.

²⁴⁷ See *id.* at 274.

²⁴⁸ See Simon et al., *supra* note 35, at 15–16.

²⁴⁹ See Ostertag, *supra* note 123, at 274.

²⁵⁰ See *id.*