
THE TAX LAWYER

Foreign Charities

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Foreign Charities'

One of the most knowledgeable observers of international nonprofit activity recently wrote:

"A striking upsurge is under way around the globe in organized voluntary activity and the creation of private, nonprofit or nongovernmental organizations. From the developed countries of North America, Europe and Asia to the developing societies of Africa, Latin America and the former Soviet bloc, people are forming associations, foundations and similar institutions to deliver human services, promote grass-roots economic development, prevent environmental degradation, protect civil rights and pursue a thousand other objectives formerly unattended or left to the state.

"The scope and scale of this phenomenon are immense. Indeed, we are in the midst of a global 'associational revolution' that may prove to be as significant to the latter twentieth century as the rise of the nation-state was to the latter nineteenth. The upshot is a global third sector: a massive array of self-governing private organizations, not dedicated to distributing profits to shareholders or directors, pursuing public purposes outside the formal apparatus of the state. The proliferation of these groups may be permanently altering the relationship between states and citizens, with an impact extending far beyond the material services they provide."¹

The enormous scope of this international activity has given rise to an urgent need for support from U.S. individuals and organizations. The legal — and particularly

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1. Lester M. Salamon, The Rise of the Nonprofit Sector, FOREIGN AFFAIRS, July/Aug. 1994, at 1 [hereinafter cited as Salamon]. For a description of, and the preliminary results of, a significant international project, headed by Prof. Salamon, designed to shed some empirical light on the global role of the third sector, see LESTER M. SALAMON & HELMUT K. ANHEIER, THE EMERGING SECTOR: AN OVERVIEW (1994).

the federal tax — structure regulating such giving, however, is ancient and bizarre. It serves more to constrain than to guide or assist. It is in great need of overhaul. This article attempts to describe, and then to criticize, the current U.S. rules.

I. Introduction

It is estimated that there are more than 500,000 charities organized in the United States.² The size of the charitable sector outside of the U.S. is obviously much greater, although available data sources are extremely inadequate. One source states that there are more than 66,000 charities in Canada, 700,000 in France, and over 170,000 in Great Britain.³

There are only approximately 1,000 foreign organizations listed as charitable on the IRS Master File of Nonprofit Entities.⁴ Only a few of them file returns with the Service.⁵ In 1985, the foreign charitable organizations that did file returns reported

2. This number derives from a straight-line extrapolation from data reported in VIRGINIA ANN HODGKINSON, MURRAY S. WEITZMAN, CHRISTOPHER M. TOPPE & STEPHEN M. NOGA, NONPROFIT ALMANAC 1992-1993: DIMENSIONS OF THE INDEPENDENT SECTOR Table 1.2 at p. 24 (1992) [hereinafter cited as NONPROFIT ALMANAC]. For purposes of this article, "charitable" entities are those described in § 501(c)(3) of the Internal Revenue Code of 1986, as amended [hereinafter cited as I.R.C.].

3. CHARITIES AID FOUNDATION, INTERNATIONAL GIVING AND VOLUNTEERING 14 (1st ed. 1994). The Canadian and Great Britain figures refer to registered charities, whereas the French figure refers to "associations which make up the French non-profit sector," so the data may not be comparable.

4. NONPROFIT ALMANAC, *supra* note 2, Table 7.FR.3, at 582 (1992). The number was 1,099 in 1987, but had dropped to 749 by 1989. Some inconsistent data are shown in Table 5.5, at p. 198, of the NONPROFIT ALMANAC, but the Table 5.5 data are believed to be inaccurate, according to Mr. Noga. For information about the Exempt Organization Master File system, see Ann. 69-22, 1969-18 I.R.B. 26, and Ann. 68-55, 1968-34 I.R.B. 54.

5. The IRS estimates, based on samples, that 72 such returns were filed in 1982, 74
(continued...)

total revenue of \$3.9 million (\$2 million of which came from contributions) and total assets of \$7 million.⁶ A recent sample of grant making by the largest U.S. foundations showed that just over 10% of total giving — amounting to over \$500 million — went either to foreign recipients or to domestic recipients for international purposes.⁷

The Conference Board estimates that "[o]ver the past 10 years, companies in the United States have increased their contributions to foreign countries by more than 500 percent"⁸ The "steep rise" from 1981 through 1990 "did not continue,"⁹ and foreign contributions from such companies "appear to be flattening."¹⁰ Nevertheless,

(...continued)

in 1983, and 143 in 1985. STATISTICS OF INCOME, COMPENDIUM OF STUDIES OF TAX-EXEMPT ORGANIZATIONS, 1974-87 at 93, 144, and 156 (Pub. 1416, 1991) [hereinafter cited as SOI COMPENDIUM].

6. SOI COMPENDIUM, supra note 5, at 156, 158.

7. THE FOUNDATION CENTER, THE FOUNDATION GRANTS INDEX 1994 Table 5, at p. ix (1993) [hereinafter cited as GRANTS INDEX]. The data derive from a sampling base of just over 65,000 grants of \$10,000 or more awarded by 960 foundations and reported between May 1992 and June 1993. Id. at vi. Although the sample includes less than 3% of all foundations, it reflects nearly 60% of total grants made, and — because it is weighted to larger foundations, which typically account for almost all international grantmaking — it probably reflects a quite large percentage of total international giving by foundations.

8. THE CONFERENCE BOARD, GLOBAL CONTRIBUTIONS OF U.S. CORPORATIONS 7 (Report No. 1019, 1993).

9. Id.

10. Id.

the median aggregate foreign donations made by reporting U.S. companies rose from less than \$100,000 in 1981 to \$429,000 in 1991.¹¹

For several reasons, all of these figures vastly understate the number and size of foreign charities: virtually no foreign charities apply to the Service for a determination letter or file information returns; the IRS Master File is seriously inaccurate; and data are sparse and unreliable with respect to the nonprofit universe, particularly with respect to foreign charities.¹²

In an increasingly interconnected global economy, international charitable activities have also grown rapidly.¹³ The collapse of communism and the emergence of nascent free markets in many previously-socialist states have also provoked growing interest in foreign charities. However, only a few articles and secondary sources address the relevant tax and other issues raised.¹⁴

11. Id.

12. That is why some of the above statistics are based only on sampling, and why the years mentioned do not match up. As Prof. Salamon has stated:

"Nonprofit organizations are incredibly diverse, and analyzing their upsurge at the global level is no simple task. A lack of systematic data, varying terminology and widely divergent functions make these organizations hard to identify from place to place. Serious definitional problems are compounded by the varied treatment of these organizations in national legal structures, with some countries explicitly providing for the incorporation of charitable or nonprofit organizations and others doing so partially or not at all. Official listings of such organizations are therefore notoriously incomplete, and their treatment in national economic statistics is grossly imperfect." Salamon, supra note 1, at 2.

13. For example, foundation giving by U.S. foundations for international purposes "has nearly doubled since 1984." GRANTS INDEX, supra note 7, at ix.

14. A selected bibliography appears as Appendix A to this article, beginning at page
(continued...)

This article will consider, in turn, (1) the U.S. tax treatment of U.S. donors (individuals, corporations, trusts and estates, private foundations, and public charities) to foreign charitable organizations, (2) the U.S. tax treatment of foreign charities themselves, and (3) certain non-tax constraints on giving to foreign § 501(c)(3) entities.

II. Treatment of U.S. Donors

A. Individuals. When a U.S. individual contributes money or property to a charity, there may be income, gift, excise, estate, or generation skipping tax consequences.

1. Income Tax. The principal provision for income tax purposes is I.R.C. § 170. Section 170(c), defining "charitable contribution," has five numbered paragraphs. For foreign charities, the second paragraph — I.R.C. § 170(c)(2) — is central.¹⁵ It includes "a contribution or gift to or for the use of . . . [a] corporation, trust, or community chest, fund, or foundation" which meets four criteria:¹⁶

1. The donee must be "created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States;"¹⁷

(...continued)

73 infra.

15. I.R.C. § 170(c)(2)(B) closely resembles I.R.C. § 501(c)(3), which — as noted above — is the source of the definition of "charity" for purposes of this article.

16. In addition to the four enumerated statutory criteria, the donee must also qualify as charitable under the standards enunciated by the Supreme Court in Bob Jones University v. United States, 461 U.S. 574 (1983). This issue will be further discussed in the text accompanying notes 176 - 194, infra.

17. I.R.C. § 170(c)(2)(A). The Service has concluded that a charitable trust, created and with its principal office at a U.S. diplomatic mission in a foreign country, could

(continued...)

2. The donee must be:

"organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children or animals;"¹⁸

3. The donee must avoid the proscription against private inurement;¹⁹ and

4. The donee must avoid the prohibitions against political campaign activity and excessive lobbying.²⁰

The first criterion is pivotal.²¹

Prior to 1938, there was no such geographical limitation for individual charitable contributions in the Code. The Revenue Act of 1935, which first gave *corporations* an income tax charitable contributions deduction, contained two geographical limitations: no corporate deduction was allowed either for gifts to foreign-organized

(...continued)

qualify under § 170(c)(2)(A). G.C.M. 37444 (March 7, 1978).

18. I.R.C. § 170(c)(2)(B). This language is closely similar to, but in interesting and important ways different than, the language of I.R.C. § 501(c)(3).

19. I.R.C. § 170(c)(2)(C).

20. I.R.C. § 170(c)(2)(D).

21. Although the charitable donee has to meet the I.R.C. § 170(c)(2)(A) place-of-organization test, it would seem that a non-charitable trust — to which a U.S. person made a gift in trust for the benefit of such a qualifying charitable donee — does *not* have to meet it. Thus, for example, a gift to a foreign trust "for the use of" a U.S. public charity should qualify under I.R.C. § 170(c), albeit subject to the 30% limitation of I.R.C. § 170(b)(1)(B) rather than the 50% limitation of I.R.C. § 170(b)(1)(A). Treas. Reg. § 1.170A-8(b).

donees or, generally, for foreign use of donated property or money.²² The Revenue Act of 1938 imposed the first of these geographical limitations (but not the second) on *individual* charitable contribution deductions:²³ it provided that no deduction was available unless the recipient was a "domestic" organization.²⁴ This restriction was not inadvertent. The legislative history said:

"The bill provides that the deduction . . . be also restricted to contributions made to domestic institutions. The exemption from taxation of money or property devoted to charitable and other purposes is based upon the theory that the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare. The United States derives no such benefit from gifts to foreign institutions, 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."²⁵

The quoted language contains bad history, because there is no indication that the tax exemption, afforded since the end of the 19th Century, was predicated on the

22. Section 102(c) of the Revenue Act of 1935, Pub. L. No. 74-407, 49 Stat. 1014, 1016 (1935), added a new § 23(r) to the Revenue Act of 1934. The relevant language permitted a deduction for:

"In the case of a corporation, contributions or gifts . . . to or for the use of a domestic corporation, or domestic trust, or domestic community trust, fund, or foundation, organized and operated exclusively for . . . charitable . . . purposes . . . (but in the case of contributions or gifts to a trust, chest, fund, or foundation, only if such contributions or gifts are to be used within the United States . . .)."

23. Section 23(o) of the Revenue Act of 1938, Pub. L. No. 75-554, 52 Stat. 447, 463 (1938).

24. Compare I.R.C. § 7701(a)(4).

25. H.R. Rep. No. 1860, 75th Cong., 3d Sess. 19-20 (1938).

quid-pro-quo rationale.²⁶ It contains bad philosophy, because the quid-pro-quo rationale for tax exemption is quite defective.²⁷ Indeed, the Service itself has expressed doubts about the quoted language on that ground, stating:

"It would seem to be at least very doubtful, however, that the well-recognized propriety of treating trusts for the advancement of religion as charitable can be adequately explained or justified on this [quid-pro-quo] basis in view of the broad constitutional restrictions in regard to the separation of church and state affairs that apply with respect to all levels of government in this country. Somewhat the same general situation likewise appears to obtain with respect to the virtually universal recognition of a charitable status for any trust which is exclusively engaged in relieving poverty or in advancing education among the residents of foreign²⁸

The legislative history also contains bad logic, because it makes no sense to deny the deduction on the basis of where the donee is organized but to permit it even if the

26. As one historian has put it:

"It is not to be supposed that the [quid-pro-quo] bargain was openly made and publicly declared. There is no direct evidence that such a bargain was ever made. The process of exempting these private institutions developed imperceptibly, subtly. It was a spontaneous process, leaving no trace of its origin or immediate development." ADLER, HISTORICAL ORIGIN OF TAX EXEMPTION OF CHARITABLE INSTITUTIONS 73 (1922).

27. See, e.g., Henry Hansmann, The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation, 91 YALE L.J. 54 (1981); Chauncy Belknap, The Federal Income Tax Exemption of Charitable Organizations: Its History and Underlying Policy (1954), reprinted in IV RESEARCH PAPERS SPONSORED BY THE COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS: TAXES 2025 (1977).

28. G.C.M. 34062 (March 3, 1969).

funds are expended abroad.²⁹ Nevertheless, the place-of-organization restriction has been part of the Code since 1938.³⁰

Note that the 1938 legislative history, quoted above, conceded that a domestic donee was permitted to use "some portion of its funds" abroad. The relevant regulations now read:

"A charitable contribution by an individual to or for the use of an organization described in section 170(c) may be deductible even though *all*, or some portion, of the funds of the organization may be used in foreign countries for charitable or educational purposes."³¹

Thus, although the Code absolutely bars income tax deductions for an individual's gifts directly to foreign charities, there is no restriction whatsoever on the foreign use

29. See the discussion in the text accompanying notes 31 - 32, *infra*.

30. See e.g., Dora F. Welti v. Commissioner, 1 T.C. 905 (1943) (no deduction for individual's gift to Swiss charitable corporation, despite its operation as a "branch" of a U.S. charitable "mother" church); Muzaffer ErSelcuk v. Commissioner, 30 T.C. 962 (1958) (no deduction for individuals' gifts to Burmese charities). Accord, Sassan Alisobhani v. Commissioner, T.C. Memo. 1994-629; Ralph Tobjy v. Commissioner, 51 T.C.M. (CCH) 449 (1986); Louise K. Herter v. Commissioner, 20 T.C.M. (CCH) 78 (1961).

31. Treas. Reg. § 1.170A-8(a)(1) (emphasis added). See also Rev. Rul. 63-252, 1963-2 C.B. 101, confirming that I.R.C. § 170(c)(2)(A) "does not restrict the area in which deductible contributions may be used." Accord, Rev. Rul. 71-460, 1971-2 C.B. 231 (charitable organization remains tax exempt even if all activities are outside U.S.); Bilingual Montessori School of Paris, Inc. v. Commissioner, 75 T.C. 480 (1980) (individual allowed income tax deductions for gifts to a U.S. organization even though all of its activities were carried out abroad). The position is long standing: see, e.g., A.R.R. 301, 3 C.B. 188 (1920) (approving charitable status for an organization formed to provide war memorials in European countries), and G.C.M. 30710 (June 4, 1958) (approving charitable status for an organization providing a water supply system in Lebanon). See also G.C.M. 30645 (Apr. 30, 1958).

of funds by U.S. charities. Furthermore, it is clear that, in pursuit of its mission, a domestic charity can properly make charitable gifts to a foreign charity.³²

An obvious question arises: is a U.S. individual donor entitled to an income tax deduction for contributions to a U.S. donee made with the expectation that the U.S. donee, in turn, will re-grant the funds to a foreign charity? The seminal authority is Rev. Rul. 63-252,³³ which considers five examples. In the first three, no income tax deduction is permitted because the U.S. charity has no discretion and must transmit certain funds to the foreign charity. In example 4, because the U.S. charity reserves the power to review and approve grants, from its general funds, to the foreign charity, the ruling permits the U.S. individual donor to claim a tax deduction. In example 5, the U.S. charity is itself active in a foreign country, where it also sometimes uses its own subsidiary foreign charity for administrative convenience but subject to complete control by the U.S. parent. Once again, the ruling permits a tax deduction.

The crucial language in the ruling is:

"[I]f an organization is required for other reasons, such as a specific provision in its charter, to turn contributions, or any particular contribution it receives, over to another organization, then in determining whether such contributions are deductible it is appropriate to determine whether the ultimate recipient of the contribution is a qualifying organization. . . . [I]t seems clear that the [geographical] requirements of section 170(c)(2)(A) of the Code would be nullified if contributions inevitably committed to go to a foreign organization were held to be deductible solely because, in the course of transmittal to the foreign organization, they came to rest momentarily in a qualifying domestic organization. In such cases the domestic organization is only nominally the donee; the real donee is the ultimate foreign recipient."

32. Rev. Rul. 63-252, 1963-2 C.B. 101; Rev. Rul. 66-79, 1966-1 C.B. 48; Rev. Rul. 69-80, 1969-1 C.B. 65; Rev. Rul. 75-65, 1975-1 C.B. 79.

33. 1963-2 C.B. 101. The ruling is supported by G.C.M. 31302 (June 29, 1959). See also G.C.M. 35319 (Apr. 27, 1973).

Rev. Rul. 63-252 has been widely misunderstood. The Service does *not* require, for example, that the domestic entity look about to see which particular foreign donee deserves the funds it receives. The Service well understands that a U.S. intermediate donee — often referred to as a "friends of" organization³⁴ — will give only to a particular named foreign entity.³⁵ It *does* require —

- that the U.S. intermediate donee not be bound to deliver the funds to the foreign entity by virtue of a charter or by-law provision;
- that gifts by the U.S. intermediate donee to the foreign entity be within the charitable mission and purpose of the U.S. entity; and
- that the U.S. intermediate donee exercise some appropriate level of scrutiny over the foreign donee to make sure that it, in turn, is an eligible charity within the meaning of I.R.C. § 501(c)(3) (the so-called "foreign equivalency" test).³⁶

34. See, e.g., James F. Bloom, Edward D. Luft & John F. Reilly, Foreign Activities of Domestic Charities and Foreign Charities, EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION TECHNICAL INSTRUCTION PROGRAM FOR FISCAL YEAR 1992 220, 229 (1991) [hereinafter cited as IRS CPE '92], applying that description to the organizations in examples 4 and 5 of Rev. Rul. 63-252.

35. That was the fact pattern in Rev. Rul. 66-79, 1966-1 C.B. 48, in which the deduction was allowed. See also the discussion in G.C.M. 37444 (March 7, 1978). Cf. Rev. Rul. 74-229, 1974-1 C.B. 142 (U.S. § 501(c)(3) qualified under § 509(a)(3) as a supporting organization for a foreign charity), discussed at note 164, infra.

36. There should be no requirement that the governing board of the U.S. charity have a different composition or different members than that of the foreign charity. Although the Service has never so stated explicitly, and although many practitioners advise to the contrary, there is some evidence that board member overlaps are not fatal. LTR 9129040 (Apr. 23, 1991) approved charitable status for a U.S. "friends of" organization that had seven directors, three of whom had to be approved by the foreign charity; two of those directors had to be present to constitute a quorum and had to vote in favor of any by-law amendments. Accord, Kimberly S. Blanchard, U.S. Taxation (continued...)

It is extremely difficult to justify the place-of-organization restriction. The rationale in the relevant legislative history is both inadequate and erroneous.³⁷ No such restrictions apply for purposes of the gift or estate tax charitable deduction.³⁸ In a world in which charity increasingly crosses — and ought to cross — national borders, U.S. donors should not be forced to resort to formalisms, such as "friends of" organizations,³⁹ in order to provide needed support abroad. Although an intermediate U.S.-organized donee may be administratively helpful, making it easier for the Internal Revenue Service to obtain and audit documents and records, there are other more suitable methods available to the Service to obtain foreign-located documents and information.⁴⁰ The easiest would be to require more detailed substantiation of foreign-targeted charitable deductions under already-existing Code provisions.⁴¹

(...continued)

of Foreign Charities, 8 EXEMPT ORG. TAX REV. 719, 726 (1993). See generally Judith S. Ballan, How to Aid a Foreign Charity Through an "American Friends of" Organization, 23 N.Y.U. CONF. TAX PLAN. FOR SECTION 501(C)(3) ORG'S ch. 4 (1994). For an interesting discussion of the same issues, but from the perspective of a Canadian donor wishing to make tax-deductible gifts into the United States, see Alison J. Youngman & Joel T. Cuperfain, Fund Raising Across the Border, BUS. L. TODAY, Nov.-Dec. 1994, at 33.

37. See the discussion in the text accompanying notes 26 - 29, supra.

38. See text accompanying notes 63 - 67 and 73 - 79, infra.

39. See text accompanying notes 33 - 36, supra.

40. Furthermore, it is not clear why such an administrative need would exist only for income, but not for gift or estate, tax purposes. In addition, there is no indication that administrative concerns motivated the adoption of I.R.C. § 170(c)(2)(A): apart from the language quoted in the text accompanying note 25, supra, the legislative history affords no further explanation for the place-of-formation limitation.

41. I.R.C. § 170(f)(8) already denies a charitable contributions deduction to donors
(continued...)

I.R.C. § 679 — Foreign Grantor Trusts

A problem may arise if a U.S. individual properly makes a gift to a U.S. charity, not viewed as a mere conduit for purposes of I.R.C. § 170, which later gives some or all of the original gift to a foreign charitable trust: might the U.S. individual be treated as the owner of any portion of the foreign trust under I.R.C. § 679? Section 679 was added to the Code in 1976⁴² to deal with a perceived tax loophole: U.S. persons previously could transfer assets to a foreign trust, which in turn could earn income free from U.S. tax until, at some later time, it distributed the income to the trust's U.S. beneficiaries. If a foreign trust has one or more U.S. beneficiaries, § 679 generally treats a U.S. transferor to the trust as the owner of the trust's assets, thus subjecting the transferor to current U.S. taxation on the trust's income.⁴³ A careful technical reading

41. (...continued)

who fail to get proper substantiation from their donees, and § 170(f)(8)(E) authorizes legislative regulations to be adopted "to carry out the purposes" of that provision. Putting the burden on the donor is appropriate, because it is only the deduction — not the status of the donee — which is at stake.

42. Tax Reform Act of 1976, § 1013, Pub. L. No. 94-455, 90 Stat. 1520, 1614 (1976). The new I.R.C. § 679 rules were made effective retroactively, however, to taxable years ending after Dec. 31, 1975, and with respect to foreign trusts created after May 21, 1974.

43. In our pattern, the U.S. individual has made a gift directly to an intermediate U.S. charity, which in turn has made a gift to a foreign charitable trust. Of course, the U.S. intermediate charity might also be subject to I.R.C. § 679. Because it is exempt from tax, however, this usually will not be painful, but it could create issues if the foreign charity generated income that would be unrelated business income to the U.S. charity, or if the income on the portion of the foreign charity's assets deemed owned by the U.S. charity changed the U.S. charity's support calculations for purposes of I.R.C. §§ 170(b)(1)(A)(vi) or 509(a)(2).

of that section suggests that it might apply in the situation described above, for several reasons:

1. Section 679 explicitly applies to direct *and indirect* transfers to foreign trusts. The legislative history contains a discussion of the indirect-transfer rule. It says that a U.S. person may be treated as making an indirect transfer to the foreign trust "if the [domestic] entity merely serves as a conduit for the transfer by the U.S. person" ⁴⁴ A footnote interprets the conduit notion as follows:

"For example, if a U.S. person transfers property to a foreign person or entity and if that person transfers that property (or its equivalent) to a foreign trust . . . the U.S. person . . . is treated as having made a transfer to a foreign trust unless it can be shown that the transfer of property to the trust was unrelated to the U.S. person's transfer of property" ⁴⁵

This conduit notion is much more sweeping than that contained in Rev. Rul. 63-252. ⁴⁶ Thus, I.R.C. § 679 might treat as a "conduit" an entity which would not be so treated under Rev. Rul. 63-252.
2. Because the hypothetical foreign trust is charitable, it must have a large and indefinite class of beneficiaries. ⁴⁷ It would be unusual for such a trust explicitly to exclude U.S. persons from benefit. But the statute treats foreign trusts as

44. S. Rep. No. 94-938, 94th Cong., 2d Sess. 219 (1976).

45. *Id.* at 219 n. 8.

46. Rev. Rul. 63-252 does not require that the two transfers be unrelated in order to avoid conduit status.

47. See, e.g., RESTATEMENT (SECOND) OF TRUSTS § 375 (1959), which provides: "A trust is not a charitable trust if the persons who are to benefit are not of a sufficiently large or indefinite class so that the community is interested in the enforcement of the trust." The Tax Court has said that "[c]harity begins where certainty in beneficiaries ends, for it is the uncertainty of the objects and not the mode of relieving them which forms the essential element of charity." *Thomason v. Commissioner*, 2 T.C. 441, 443 (1943). See generally G.C.M. 39876 (June 20, 1992).

having U.S. beneficiaries unless such an exclusion is specifically part of the trust terms.⁴⁸

3. Not only is there no exception in the section for charitable trusts, but there *is* an exception for certain employee trusts.⁴⁹

Each of these points tends to exacerbate the risk that § 679 will apply to transfers by a U.S. individual to a foreign charitable trust. Because no regulations have been adopted or proposed under § 679, the Service has declined to rule on the issue.⁵⁰

It is unlikely, nevertheless, that § 679 would actually be applied to an indirect transfer to a foreign charitable trust.⁵¹ Although the most desirable approach would be a legislative fix, perhaps the Treasury or the Service would now be willing to cor-

48. I.R.C. § 679(c)(1)(A).

49. Section 679(a)(1) excludes "a trust described in section 404(a)(4) or section 404A" from coverage.

50. LTR 8550042 (Sept. 18, 1985). The ruling involved the creation of a foreign charitable annuity lead trust. It holds that, because "no regulations have been adopted that interpret section 679 of the Code . . . no ruling will be issued concerning whether or not the Donor will be treated as the owner of any portion of the Trust for federal income tax purposes under section 679 of the Code."

There are several rulings that hold that a charitable remainder trust is not a grantor trust under § 679, e.g., LTR 8932018 (May 11, 1989), LTR 8631034 (May 1, 1986), LTR 8446054 (Aug. 17, 1984). In each, however, § 679 is mentioned only as part of the grantor-trust sections in the Code (e.g., by reference to §§ 671-79); in none is there any separate discussion of § 679; in none does any fact suggest that a foreign trust was involved. The rulings rely on Treas. Reg. § 1.664-1(a)(4), expressly excepting charitable remainder trusts from the grantor-trust rules.

51. Indeed, it is puzzling to contemplate how the "portion" rule would operate in such a case. I.R.C. § 679(a)(1) treats the indirect U.S. transferor of property as the grantor "of *the portion* of such [foreign] trust attributable to such property . . ." [emphasis added]

rect the situation by a regulation or ruling. Failing either legislative or administrative clarification, the only completely safe routes are to insure either that the ultimate foreign charitable recipient is in corporate, rather than trust, form, or that U.S. persons are explicitly excluded from the foreign charity's beneficiary class.

Bilateral Income Tax Treaties

Three of our bilateral income tax conventions permit an income tax deduction for a direct gift by a U.S. person to a foreign charity.⁵² Under Article 22(2) of the U.S.-Mexico treaty, a U.S. individual is explicitly granted a deduction for a direct gift to a Mexican charity so long as the donee is subject to a Mexican law that provides standards "essentially equivalent" to the United States law regulating charitable organizations.⁵³ Mexico has already adopted legislation which is intended to be "essentially

52. Congress historically has been reluctant to extend the charitable deduction by treaty, and rejected a similar provision in Article 22 of the Brazil-U.S. treaty. For a general discussion, see Zack D. Mason, Foreign Charitable Contribution Deductions: A Shift in U.S. Tax Treaty Policy?, 7 EXEMPT ORG. TAX REV. 624 (1993). See also Milton Cerny, Cross-Border Grant Making and the U.S.-Mexico Tax Treaty, 10 EXEMPT ORG. TAX REV. 875 (1994); Thomas A. Troyer, EO Practitioners Alerted to Importance of U.S.-Mexico Tax Treaty, 10 EXEMPT ORG. TAX REV. 877 (1994); Milton Cerny, U.S.-Israel Tax Treaty, 10 EXEMPT ORG. TAX REV. 1156 (1994).

53. The Mexican law must also define the Mexican charities as "public" or "private." The treaty language is interesting:

"If the Contracting States agree that a provision of Mexican law provides standards for organizations authorized to receive deductible contributions that are essentially equivalent to the standards of United States law for public charities:

- "a) an organization determined by Mexican authorities to meet such standards shall be treated, for purposes of grants by United States private foundations and public charities, as a public charity under United States law, and

(continued...)

equivalent" to the relevant U.S. law,⁵⁴ and the U.S. has agreed that it does provide "essentially equivalent standards" for Mexican organizations within its coverage (but not including churches).⁵⁵

Under certain circumstances, U.S. individuals can also get a deduction for direct gifts to a Canadian charity. Article XXI(5) of the Canadian-U.S. treaty, however, does

53. (...continued)

"b) contributions by a citizen or resident of the United States to such an organization shall be treated as charitable contributions to a public charity under United States law.

"However, contributions described in subparagraph (b) shall not be deductible in any taxable year to the extent that they exceed an amount determined by applying the limitations of the laws of the United States in respect to the deductibility of charitable contributions to public charities (as they may be amended from time to time without changing the general principle hereof) to the income of such citizen or resident arising in Mexico. The preceding sentence shall not be interpreted to allow in any taxable year deductions for charitable contributions in excess of the amount allowed under the limitations of the laws of the United States in respect to the deductibility of charitable contributions."

54. Article 70-B of the Mexican Income Tax law.

55. Per Art. 17(b) of the first protocol to the Treaty, Protocol with Respect to Taxes on Income, Sept. 18, 1992, U.S.-Mex., S. Treaty Doc. No. 7, 103d Cong., 1st Sess (1993). See also JOINT COMMITTEE ON TAXATION, EXPLANATION OF PROPOSED INCOME TAX TREATY (AND PROPOSED PROTOCOL) BETWEEN THE UNITED STATES AND MEXICO 89 (JCS-16-93, Oct. 26, 1993).

not rely on Canadian legislation but rather applies U.S. standards⁵⁶ to the Canadian donee.

On September 23, 1994, the U.S. Senate finally consented to the adoption of the 1975 U.S.-Israel treaty, including Article 15A (from a 1980 protocol) permitting U.S. individuals a deduction for direct contributions to charities organized in Israel.⁵⁷ Instruments of ratification were exchanged by the United States and Israel on November 30, 1994; the treaty will enter into force on January 1, 1995. As in the Canadian case, the treaty does not rely on Israeli legislation to set standards for eligible donees; it applies U.S. standards.

In the case of both Canada and Mexico, U.S. percentage limitations on the charitable deduction⁵⁸ apply; in the case of Israel, however, the percentage limitation is

56. Under I.R.C. § 170(c). Procedures to establish that a Canadian entity does qualify under U.S. standards are set forth in Rev. Proc. 59-31, 1959-2 C.B. 949. Section 3.02 of that Revenue Procedure requires the Canadian entity to apply to the Service for a determination of its status, and to attach to its application "a certified copy of the ruling letter issued to it by the country under whose laws it was created or organized and which ruling holds, in effect, that contributions to it qualify for an income tax deduction under the laws of such country." The Service continues to apply the 1959 Revenue Procedure even to the current (1984) Canadian treaty. IRS CPE '92, supra note 34, at 253.

57. See John Turro, Senate Action Paves Way for U.S.-Israel Treaty to Take Effect, 65 TAX NOTES 37 (Oct. 3, 1994). Article 15A of the treaty is quoted in full in Milton Cerny, U.S.-Israel Tax Treaty, 10 EXEMPT ORG. TAX REV. 1156, 1157 (1994).

58. Under I.R.C. § 170(b). There is an exception in the Canadian treaty permitting deductions, beyond the normal U.S. limitations applied to Canadian income, for "contributions to a college or university at which the [U.S.] citizen or resident or member of his family is or was enrolled." The exception is not to be applied, however, to allow total deductions in excess of the § 170 limitations applied to worldwide income of the donor. "A note exchanged when the treaty was submitted makes clear that the term 'family' includes brothers and sisters, whether of the whole or half blood or

(continued...)

fixed by the treaty at 25%.⁵⁹ In all three treaties, the relevant limitations are calculated by reference solely to the donor's income from sources within the foreign treaty state, i.e., Mexico, Canada, or Israel respectively.

Future U.S. bilateral tax treaties are unlikely to contain similar provisions.⁶⁰ The Senate has expressed grave concern about using the treaty process to grant charitable contribution deductions that otherwise would be denied under I.R.C. § 170(c)(2)(A). Thus, for example, the Senate Foreign Relations Committee Report on the U.S.-Mexico Income Tax Treaty states:

"A provision requiring the granting of deductions for contributions to treaty country charities is found in only one currently effective U.S. income tax treaty — the treaty with Canada — and in one income tax treaty that is not yet in force — the treaty with Israel. The Committee enunciated strong concerns with respect to those provisions, and made it clear that future treaties containing similar provisions would be closely scrutinized.

"As has been previously pointed out with respect to the Canadian and Israeli treaties, the Committee is concerned with granting deductions to U.S. persons by treaty in cases where the Congress has chosen not to do so under the Internal Revenue Code. The Committee does not believe that the practice of allow

(...continued)

adopted, spouse, ancestors, lineal decedents, and adopted descendants." IRS CPE '92, supra note 34, at 254.

59. Article 15A(1). Because treaties are generally interpreted to help but not hurt a taxpayer, the 25% limit should not be applied to restrict any higher percentage limitation available to a U.S. individual giving to Israeli charitable causes, e.g., through a "friends of" U.S. intermediary charity.

60. For a somewhat contrary, albeit tentative, view, see Zack D. Mason, Foreign Charitable Contribution Deductions: A Shift in U.S. Tax Treaty Policy?, 7 EXEMPT ORG. TAX REV. 624 (1993).

ing tax deductions to U.S. persons for contributions to charities in foreign countries should be expanded by the treaty process."⁶¹

The Treasury Department appears to agree. Under questioning from Senator Sarbanes at a hearing before the Senate Foreign Relations Committee on October 27, 1993, Assistant Secretary of the Treasury Samuels stated:

"[I]n those very limited cases [of Canada and Mexico] I think, given the relationships with the countries that it is appropriate. But I do agree with you, Senator, and your question that it is something that we do on an exceptional basis and not as a general part of our policy."⁶²

2. Gift Tax. Living donors to charities not only must aim to clear the income tax hurdles discussed above, but also must try to qualify their donations for the gift

61. S. Exec. Rep. No. 103-20, 103d Cong., 1st Sess. 25 (1993). The Staff of the Joint Committee on Taxation, in its explanation of the Mexican treaty, expressed similar deep concerns, quoted at some length from earlier expressions of these concerns in the Senate reports on the Israeli and Canadian treaties, and concluded:

"Given the Committee's view that treaties generally are not the proper forum for expanding the allowance of charitable contribution deductions beyond the provisions of the Internal Revenue Code, the Committee must decide whether the relationship between the United States and Mexico is special enough to warrant an exception to that general principle." STAFF OF THE JOINT COMMITTEE ON TAXATION, 103D CONG., 1ST SESS., EXPLANATION OF PROPOSED INCOME TAX TREATY (AND PROPOSED PROTOCOL) BETWEEN THE UNITED STATES AND MEXICO 23-24 (Comm. Print 1993).

62. Tax Conventions with: the Russian Federation, Treaty Doc. 102-39; United Mexican States, Treaty Doc. 103-7; the Czech Republic, Treaty Doc. 103-17; the Slovak Republic, Treaty Doc. 103-18; and the Netherlands, Treaty Doc. 103-6. Protocols Amending Tax Conventions with: Israel, Treaty Doc. 103-16; the Netherlands, Treaty Doc. 103-19; and Barbados, Treaty Doc. 102-41; Hearing Before the Senate Committee on Foreign Relations, 103d Cong., 1st Sess. 45 (Oct. 27, 1993).

tax charitable deduction. Because the shape of the latter differs from the former, it is quite possible to satisfy only one of the two.⁶³

The language of I.R.C. § 2522(a)(2) — dealing with gifts to charities by U.S. citizens or residents — is almost identical to the language of I.R.C. § 170(c)(2)(B).⁶⁴ It does not, however, contain any geographical limitation.⁶⁵ This hopeful sign is explicitly confirmed by the regulations, which state:

"The deduction is not limited to gifts for use within the United States, or to gifts to or for the use of domestic corporations, trusts, community chests, funds, or foundations, or fraternal societies, orders, or associations operating under the lodge system."⁶⁶

63. As only one example, although a gift to a possession of the United States qualifies under I.R.C. § 170(c)(1), it does not qualify under I.R.C. § 2522(a)(1).

64. There are differences, however, that puzzle, annoy, or confound. For example, the gift tax provision specifically approves donations for "the encouragement of art," whereas the income tax provision is silent on this point. (The quoted language also appears in several other sections, including I.R.C. §§ 2055(a)(2), 2106(a)(2)(A)(ii), 2522(b)(2), and 2522(b)(4).) This particular verbal inconsistency seems to be without legal significance: e.g., Treas. Reg. § 1.509(a)-3(j)(3), Example (3), deals with "a national foundation for the encouragement of art" which is "an organization described in section 170(b)(1)(A)(vi)"; there would be no purpose in including the foundation within § 170(b)(1)(A) unless it were also within § 170(c). Each such inconsistency, however, suggests a potential legal distinction, and requires research — often unavailable — to locate guidance.

65. By contrast, in the case of nonresidents, I.R.C. § 2522(b)(2) restricts the charitable deduction to gifts to *domestic* corporations, and I.R.C. § 2522(b)(3) restricts the deduction to gifts to be used within the United States if the donee is a trust. There appears to be no place-of-use restriction if the gift is to a domestic corporation, nor any place-of-organization restriction if the gift is to a trust. Accord, Treas. Reg. § 25.2522(b)-1.

66. Treas. Reg. § 25.2522(a)-1(a).

Thus, donations by U.S. individuals directly to foreign charities will qualify for the gift tax charitable deduction.⁶⁷

3. I.R.C. § 1491 Tax. If the foreign charity is organized as a trust or corporation, the 35% excise tax of I.R.C. § 1491 at first might appear to apply to a U.S. person's transfer of property to the charity.⁶⁸ The tax applies only to transfers of appreciated property, and therefore is likely to affect inter vivos rather than testamentary transfers.⁶⁹ There is an exception, however, for transfers to foreign charities.⁷⁰ Thus,

67. Because of the linguistic differences between I.R.C. § 170(c)(2)(B) and I.R.C. § 2522(a)(2), a prudent adviser will make sure that the foreign charity fits the particular description in the latter section.

68. The tax applies to any "transfer of property by a citizen or resident of the United States . . . to a foreign corporation as paid-in surplus or as a contribution to capital, or to a foreign . . . trust" I.R.C. § 1491. Although the tax also may apply to certain transfers to foreign estates and foreign partnerships, those entities are beyond the scope of this article, since estates and partnerships cannot qualify as charities under I.R.C. § 501(c)(3). It is not clear whether a donation to a foreign corporate charity would be "as paid-in surplus or as a contribution to capital." If not, the donation would escape tax without having to pass through the I.R.C. § 1492(1) exception, thus leaving that exception to function only in the case of donations to foreign charities in trust form.

69. I.R.C. § 1014(a) generally provides a fair market value basis for inherited property. There are some important exceptions, e.g., for property representing income in respect of a decedent (per I.R.C. §§ 691 and 1014(c)), stock of foreign personal holding companies (per I.R.C. § 1014(b)(5)), stock of DISCs (per I.R.C. § 1014(d)), stock of foreign investment companies (per I.R.C. § 1246(e)), and stock of passive foreign investment companies (per I.R.C. § 1291(e)). And, of course, the property may later appreciate in value even above the fair market value for estate tax purposes.

70. I.R.C. § 1492(1) excepts transfers to organizations "exempt from income tax under part I of subchapter F of chapter 1 (other than an organization described in section 401(a))." The regulations translate, specifying I.R.C. §§ 501-04. Treas. Reg. §
(continued...)

if the transferee foreign charity meets the standards of I.R.C. § 501(c)(3), the § 1491 tax will not apply.⁷¹ It generally is necessary to file Form 926 despite satisfying the exception,⁷² although compliance with this requirement is probably quite rare.

4. Estate Tax. The estate tax charitable deduction is couched in language that, although similar to that used for the gift tax, varies in inexplicable ways.⁷³ Indeed, there are unfathomable differences in language even between the two paragraphs of the estate tax charitable deduction section that deal, respectively, with transfers to corporations and transfers to trustees.⁷⁴ One might approach the differences by trying to discern what sorts of distinctions were intended. That approach is *not* to be encouraged. It is not merely that, in the words of Mr. Justice Jackson, this is a "line . . . drawn by an unsteady hand"⁷⁵ — it appears that the draftsman was staggering drunk.⁷⁶

(...continued)

1492-1(a)(1). Because I.R.C. § 1491 only taxes transfers to *foreign* trusts, the exception must be focussed on foreign charitable trusts.

71. Discussion is deferred to later in this article of how a foreign charity qualifies under I.R.C. § 501(c)(3). Note that the exception in I.R.C. § 1492(1) confirms that foreign charities may indeed so qualify, at least under certain circumstances.

72. Treas. Reg. § 1.1494-1(b). The regulation requires that a copy of the foreign charity's IRS determination letter be attached to the Form 926 if such a letter has been obtained. Treas. Reg. § 1.1494-1(b)(2). In other cases, a certificate, sworn to by the transferor, must be appended to the Form 926 and must set forth "complete information" to establish that the foreign donee would qualify under I.R.C. § 501(c)(3). Treas. Reg. § 1.1494-1(b)(1).

73. Compare I.R.C. §§ 2055(a)(2) and (3) with I.R.C. § 2522(a)(2).

74. Contrast I.R.C. § 2055(a)(2) with I.R.C. § 2055(a)(3).

75. United States v. Allegheny County, 322 U.S. 174, 176 (1944).

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This much appears to be reasonably clear: for U.S. citizens or residents, there is no geographical limitation for purposes of the estate tax charitable deduction.⁷⁷ The regulations confirm that "[t]he deduction is not limited, in the case of estates of citi-

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76. For example, if the linguistic differences indeed signalled intended legal differences:

1. A direct bequest to a foreign corporate charity for the encouragement of art would qualify for the deduction, but a bequest to foreign trustees for such purpose would not. (I.R.C. § 2055(a)(2) contains the "encouragement of art" language, but I.R.C. § 2055(a)(3) does not.)
2. A direct bequest to a foreign corporate donee would fail if the donee violated the proscription against private inurement, but a bequest to foreign trustees would qualify for the deduction notwithstanding a violation of the private inurement rules. (I.R.C. § 2055(a)(2) contains anti-inurement language, but I.R.C. § 2055(a)(3) does not.)
3. A direct bequest to a foreign corporate charity to foster amateur sports competition would qualify for the deduction, but a bequest to foreign trustees for such purpose would not. (I.R.C. § 2055(a)(2) contains the amateur-sports-competition language, but I.R.C. § 2055(a)(3) does not.)
4. An inter vivos gift to a foreign community chest, fund, or foundation would qualify for the gift tax charitable deduction, but a bequest to such an entity would not qualify for the estate tax charitable deduction. (I.R.C. § 2522(a)(2) enumerates those entities in addition to corporations and trusts, but I.R.C. §§ 2055(a)(2) and (3) do not.)

77. In the case of estates of nonresident aliens, there *is* a geographical restriction in the charitable deduction provision: I.R.C. § 2106(a)(2)(A)(ii) limits the deduction to domestic organizations where the beneficiary is a corporation, and I.R.C. § 2106(a)(2)(A)(iii) limits the deduction to domestic use where the beneficiary is a trustee. There appears to be no place-of-use restriction in the former case, nor any place-of-organization restriction in the latter. This result seems to be confirmed by Treas. Reg. § 20.2106-1(a)(2)(i).

zens or residents of the United States, to transfers to domestic corporations or associations, or to trustees for use within the United States."⁷⁸ Thus, direct bequests to foreign charities will generally qualify for the estate tax charitable deduction.⁷⁹

5. Generation Skipping Tax. There is no explicit charitable deduction provision in the GST rules, but charities are generally "assigned to the transferor's generation."⁸⁰ Although the statutory chain is a bit tedious,⁸¹ the result is fairly clear: transfers to charities do not trigger the tax. The definition of charity for this purpose oper

78. Treas. Reg. § 20.2055-1(a). The drafting of the quoted portion of the regulation leaves much to be desired — for example, does the explicit blessing of foreign use by trustees signal condemnation of foreign use by corporate transferees? — but the general message seems intelligible. One article, which states in part that no estate tax charitable contribution deduction would be available for testamentary gifts to a foreign trust, is simply wrong on that point. Zack D. Mason & Mark B. Persellin, Type of Tax Governs Foreign Charitable Contributions Planning, 5 J. INT'L TAX'N 74, 77 (Feb. 1994). A recent training manual of the IRS confirms this, explicitly stating: "Unlike IRC 170(c), however, IRC 2055 also permits deductions for bequests to charitable trusts without requiring that the trusts be domestic organizations." IRS CPE '92, supra note 34, at 231-32.

79. As in the case of the gift tax, a prudent adviser will make sure that a bequest fits the particular language in I.R.C. §§ 2055(a)(2) or (3), as appropriate.

80. I.R.C. §§ 2651(e)(3)(A) and (B).

81. I.R.C. § 2601 imposes tax on a "generation skipping transfer." I.R.C. § 2611(a) defines that phrase generally to include "a taxable distribution," "a taxable termination," and "a direct skip." I.R.C. § 2612, in turn, defines each of the last three quoted phrases to involve an interest in the property being held by a "skip person." Finally, I.R.C. § 2613(a) defines "skip person" generally to be individuals "assigned to a generation which is 2 or more generations below the generation assignment of the transferor." Since I.R.C. § 2651(e)(3) assigns charities to the transferor's generation, charities are not "skip persons," and their receipt of an interest in the property is not a "generation skipping transfer."

ates by cross reference,⁸² but the ultimate definitional provisions — which merely incorporate § 501(c)(3)⁸³ — contain no geographical restrictions either on the place of formation of the charity or on the place of use of its assets.⁸⁴ Thus, transfers to foreign charities should not trigger the generation-skipping tax.

B. Corporations. When a U.S. corporation contributes money or property to a charitable organization, there may be income or excise tax consequences.⁸⁵

1. Income Tax. As in the case of individuals, the principal provision for corporate income tax purposes is I.R.C. § 170. Because the Code definition of "charitable contribution" does not turn on the nature of the donor, the discussion of the income tax rules for individuals is also directly applicable to corporations.⁸⁶

82. I.R.C. § 2651(e)(3)(A) refers to organizations described in I.R.C. § 511(a)(2), and I.R.C. § 2651(e)(3)(B) refers to organizations described in I.R.C. § 511(b)(2).

83. I.R.C. § 511(a)(2), in relevant part, refers to "any organization . . . which is exempt . . . from taxation under this subtitle by reason of section 501(a)." I.R.C. § 511(b)(2), in relevant part, refers to "any trust which is exempt . . . from taxation under this subtitle by reason of section 501(a)." I.R.C. § 501(a), in turn, exempts organizations "described in subsection (c)," which, of course, includes charities as described in I.R.C. § 501(c)(3).

84. See the discussion of the circumstances in which a foreign entity may qualify as a § 501(c)(3) entity in the text accompanying notes 171 - 209, infra.

85. Corporate transfers do not trigger gift, estate, or GST tax problems for the corporation because, for those tax purposes, the corporate transfer is deemed to have been made proportionately by the individual shareholders. E.g., Treas. Reg. § 25.2511-1(h)(1) (gift tax).

86. That also includes the I.R.C. § 679 risk, discussed in the text accompanying notes 43 - 51, supra.

There is a second consideration, however, that concerns only corporate, not individual, donors — the flush language at the end of I.R.C. § 170(c)(2) provides, in relevant part:

"A contribution or gift by a corporation to a trust, chest, fund, or foundation shall be deductible by reason of this paragraph only if it is to be used within the United States or any of its possessions"

This place-of-use restriction is a carryover from the 1935 legislation⁸⁷ that first granted corporations a charitable contribution deduction.

Significantly, the quoted language applies only to gifts by a corporation to "a trust, chest, fund, or foundation."⁸⁸ By contrast, § 170(c)(2) generally refers to gifts to "a corporation, trust, or community chest, fund, or foundation." The latter enumeration, but not the former, includes corporations within the donee class. There are many instances in the Code in which such differences in itemization mean nothing.⁸⁹ In this case, however, they do: the Service has confirmed that gifts by a corporation to a domestic *corporate* donee, as distinguished from domestic trusts, chests, funds, or foundations, *may* be expended outside the U.S. without depriving the corporate donor of its income tax deduction.⁹⁰ There is no indication that Congress thought about

87. See supra note 22.

88. That enumeration is repeated in Treas. Reg. § 1.170A-11(a), without comment or clarification.

89. For example, although I.R.C. § 170(c)(2) refers to trusts, I.R.C. § 501(c)(3) does not. Does it follow that trusts cannot qualify under the latter section? Of course not: charitable trusts are quite common. The regulations confirm this, perhaps most explicitly at Treas. Reg. § 1.501(c)(3)-1(b)(2), which defines "articles of organization" to include "the trust instrument."

90. Rev. Rul. 69-80, 1969-1 C.B. 65. This restates a much earlier precedent to the same effect, I.T. 3048, 1937-1 C.B. 85, declared obs., Rev. Rul. 68-100, 1968-1 C.B.

(continued...)

why the place-of-use restriction should depend on the legal form of the domestic char

(...continued)

572. The Service confirmed that the obsolescence of I.T. 3048 did not change the legal rule. LTR 6810090140A (Oct. 9, 1968).

ity.⁹¹ Nevertheless, the lesson is clear, and U.S. corporate donors have good reason to

91. The legislative history in 1935 — the date of original enactment — is unenlightening. Some 1942 legislative history, however, does bear on the question. All it demonstrates, unfortunately, is that the provision in question was misunderstood by the Senate.

The 1942 legislation, as it emerged from the House, did not change the language of the provision (then in § 23(q) of the Internal Revenue Code of 1939, Pub. L. No. 76-1, 53 Stat. 1, 14 (1939)), leaving it in essentially the same form in which it had appeared previously (and in which it still appears at the end of § 170(c)(2)). The Senate proposed to delete the place-of-use restriction altogether. The Senate report, however, seems to indicate that the Senate thought (erroneously, of course) that the restriction applied to domestic *corporate* donees as well as to other forms of domestic charities. It said:

"Under the existing law, a corporation is entitled to a deduction for charitable contributions only if such contributions are gifts or to be used within the United States or any of its possessions by corporations, trusts, community trust funds, or foundations organized in the United States or in any possession thereof and operated exclusively for religious, charitable, scientific, or educational purposes.

"It is believed in view of the present situation that it is unwise to limit this deduction to contributions or gifts used within the United States or any of its possessions. Accordingly, the bill provides that the deduction shall be allowed to corporations created or organized for the purposes described even though such gifts or contributions are used outside of the United States or its possessions." S. Rep. No. 1631, 77th Cong. 2d Sess. 51, 1942-2 C.B. 546.

The Conference Committee restored the prior language, thus leaving place-of-use restrictions for domestic charities other than corporate charities. The Conference Committee report said only:

"The [Senate] amendment deletes the provision contained in existing law which limits corporate charitable deductions to those contributions or gifts which are to be used only within the United States or its possessions. The House recedes, with an amendment which provides that contributions to a trust, chest, fund, or
(continued...)

prefer charities that are corporate in form.

A third income tax issue for corporate donors involves the impact of the charitable contribution deduction on the corporation's foreign tax credit.⁹² If a U.S. corporation makes a deductible gift to a charity, and the gift is used (in whole or in part) for charitable purposes outside of the U.S., how is the deduction to be allocated or apportioned for purposes of the foreign tax credit limitation fraction?⁹³ To the extent that it must be allocated to foreign-source income, that will reduce the limitation fraction and diminish the donor corporation's ability to credit foreign taxes.⁹⁴

(...continued)

foundation made within a taxable year beginning after the end of the war shall be deductible only if they are to be used within the United States or its possessions." H. Rep. No. 2586, 77th Cong., 2d Sess. 40, 1942-2 C.B. 705.

Whatever the Congressional confusion, this at least confirms that the place-of-use restriction depends on the form of the domestic charity, and that it does not apply to domestic corporate charities.

92. This problem might also arise for individual donors, but the likelihood of that is less and the dimension of the issue is probably quite small if it does arise.

93. I.R.C. § 904.

94. Because of the general lowering of corporate tax rates in 1986, U.S. corporations quite frequently have been in excess credit position in any event, which would tend to make this particular allocation question of less importance. There are signs, however, that U.S. corporations have become more creative in reducing foreign taxes since 1986. It would follow that this issue would become relatively more significant. Indeed, charities have been concerned that a more rigid requirement of allocation of charitable deductions to foreign-source income would chill giving even if, by the time all year-end calculations are done, the potential U.S. corporate donors would not have been adversely affected by a more rigid rule.

The present regulations treat the charitable deduction as "not definitely related to any gross income"⁹⁵ and thus to be apportioned on the basis of gross income ratios.⁹⁶ Prompted by the enactment of I.R.C. § 864(e),⁹⁷ however, the Treasury re-examined the issue, and, in early 1991, proposed new regulations to deal with the question.⁹⁸ They contain a three-tiered rule:

1. If the donor corporation both designates the gift for use solely within the U.S., and "reasonably believes" that it will be so used, then the deduction will be allocated entirely against U.S.-source income, unless the gift is described in paragraph 2 below.⁹⁹
2. If the donor corporation "knows or has reason to know" that the gift will be, or "may necessarily be," used entirely outside the U.S., then the deduction will be allocated entirely against foreign-source income.¹⁰⁰

95. Treas. Reg. §§ 1.861-8(e)(9)(iv).

96. Treas. Reg. § 1.861-8(c)(3).

97. Added by the Tax Reform Act of 1986, § 1215(a), Pub. L. No. 99-514, 100 Stat. 2085, 2544 (1986). I.R.C. § 864(e)(7) authorizes the Secretary of the Treasury to prescribe "such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations providing . . . (C) for the apportionment of expenses allocated to foreign source income among . . . various categories of income described in section 904(d)(1)"

98. Prop. Reg. § 1.861-8(e)(12), 56 Fed. Reg. 10,395 (Mar. 12, 1991), corrected by 56 Fed. Reg. 12,140 (Mar. 22, 1991).

99. Prop. Reg. § 1.861-8(e)(12)(i).

100. Prop. Reg. § 1.861-8(e)(12)(ii).

3. In all other cases, the deduction will be "ratably apportioned . . . on the basis of gross income" ¹⁰¹

Further special rules are provided for substantial contributors to private foundations ¹⁰² and members of an affiliated group. ¹⁰³

The proposed regulation occasioned a great outcry from multinationals and from charities having significant foreign activities. ¹⁰⁴ At least one Congressional Committee expressed concern. ¹⁰⁵ The Service and Treasury backed away, and the proposed regulation has not been made final. ¹⁰⁶ Legislation was proposed in President Bush's last Budget Message to change the proposed rules, and to permit allocation of such deductions entirely against U.S.-source income. It was not passed and has not been re-introduced. There has been little recent commotion on this question. A reasonable prediction would be: (i) no activity on this front in the near future, and

101. Prop. Reg. § 1.861-8(e)(12)(iii).

102. Prop. Reg. § 1.861-8(e)(12)(iv).

103. Prop. Reg. § 1.861-8(e)(12)(v).

104. The great majority of the comments clearly misunderstood the issue, and tended to complain about denial of the charitable contribution deduction. A few were more careful, however, e.g., Tax Executives Institute, Comments on Proposed Regulations on the Allocation and Apportionment of Charitable Contributions, 43 TAX EXEC. 363 (1991).

105. The Senate Committee on Appropriations worried that the proposed regulations "could seriously jeopardize charitable contributions to U.S. charities with international missions and programs in the developing world," expressed its view that they were "particularly misguided," and urged the Treasury "to revise these regulations . . ." S. Rep. No. 95, 102d Cong., 1st Sess. 41-42 (1991).

106. See, e.g., John Turro, International Charities Attack Proposed Sourcing Rules, 52 TAX NOTES 627 (Aug. 5, 1991); Comments Cause Treasury to Evaluate Charitable Allocation Regs., 52 TAX NOTES 1577 (Sept. 30, 1991).

(ii) no great likelihood of the currently-proposed regulations being adopted without at least some changes.¹⁰⁷

2. I.R.C. § 1491 Tax. A U.S. corporate donor to a foreign charity is treated no differently, for purposes of § 1491, than a U.S. individual donor. Thus, the discussion of this subject, beginning at p. 22 above, is equally applicable here.

C. Trusts and Estates. In lieu of the I.R.C. § 170 deduction, estates and complex trusts¹⁰⁸ are granted a special deduction, under I.R.C. § 642(c)(1), for amounts paid to charities.¹⁰⁹ It is unlimited, and — although the recipient must be described in

107. For further commentary, see Frances R. Hill, Allocating Charitable Contributions for Foreign Tax Credit Purposes, CORP. TAX'N, Sept./Oct. 1991, at 18; Jolie F. Zimmerman, Note, The Tax Consequences of Debt-for-Nature Swaps: Foreign-Tax-Credit Limitations and the Need for Clarification, 45 TAX LAW. 1083 (1992); T. Timothy Tuerff, Richard A. Gordon & Andrew C. Newman, Allocation of State Income Tax and Charitable Contribution Deductions: An Exercise in Mixing Oil and Water, 20 TAX MGMT. INT'L J. 398 (1991); Mike McIntyre, The Charitable Deduction Allocation Rules — Complex, Wrong-headed, and Unprincipled, 3 TAX NOTES INT'L 737 (1991).

108. Although I.R.C. § 642(c)(1) by its terms does not apply to simple trusts, a trust for the benefit of charity generally is not a simple trust. I.R.C. § 651(a)(2). The regulations explain that this is an annual determination, that merely having a charitable beneficiary does not automatically make a trust complex, and that the issue turns on whether the trust is allowed a deduction under I.R.C. § 642(c) for the taxable year in question. Thus, for example, a charitable remainder trust may qualify as a simple trust under certain circumstances. Treas. Reg. § 1.651(a)-4. Under limited circumstances, a trust which is itself treated as a charity (e.g., by virtue of I.R.C. § 4947(a)(1)) might also be treated as a private foundation which is not exempt from tax (e.g., by virtue of I.R.C. § 508(e)(1)). Such a trust will not be entitled to the I.R.C. § 642(c) deduction, but will be entitled to one under I.R.C. § 170 instead, per I.R.C. § 642(c)(6). See also Treas. Reg. § 1.642(c)-4. In such a case, presumably, the geographical place-of-organization restriction of I.R.C. § 170(c)(2)(A) would apply.

109. The I.R.C. § 642(c) deduction is the exclusive deduction available for estates' (continued...)

I.R.C. § 170(c) — the deduction is "determined without regard to section 170(c)(2)(A)."¹¹⁰ The regulations amplify:

109. (...continued)
and trusts' charitable gifts. The regulations make clear that "[a]mounts paid, permanently set aside, or to be used for charitable, etc., purposes are deductible by estates or trusts *only* as provided in section 642(c)." Treas. Reg. § 1.663(a)-(2) (Emphasis added.) Accord, United States Trust Co. v. Internal Revenue Service, 803 F.2d 1363 (5th Cir. 1986); Pullen v. United States, 80-1 U.S.T.C. ¶ 9105 (D. Neb. 1979) (not officially reported), aff'd (per curiam, without opinion, on the opinion of the district court) (8th Cir. 1980); Estate of O'Connor v. Commissioner, 69 T.C. 165 (1977); Mott v. United States, 462 F.2d 512 (Ct. Cl. 1972), cert. denied, 409 U.S. 1108 (1973); Rev. Rul. 68-667, 1968-2 C.B. 289. For a detailed (and critical) discussion of this line of authority, see Leo L. Schmolka, Income Taxation of Charitable Remainder Trusts and Decedents' Estates: Sixty-Six Years of Astigmatism, 40 TAX L. REV. 1, 278-95 (1984) [hereinafter cited as SCHMOLKA]. It remains unclear, however, whether a deduction under I.R.C. § 661 is available to an estate for amounts paid in satisfaction of a bequest to a charitable remainder trust. Such a trust imposes its own geographic limitations because it must incorporate I.R.C. § 170(c) whole, per I.R.C. §§ 664(d)(1)(C) and 664(d)(2)(C). For an analysis of this final point, see SCHMOLKA, supra this footnote, at 295-306.

110. I.R.C. § 642(c)(1). That paragraph applies to amounts "paid" for charitable purposes. By contrast, I.R.C. § 642(c)(2), dealing with amounts "set aside" or "to be used" for charitable purposes, lacks the direction to disregard I.R.C. § 170(c)(2)(A). Furthermore, the regulations under I.R.C. § 642(c)(2) — Treas. Reg. § 1.642(c)-2 — lack language, like that quoted below in the text accompanying note 111, confirming that no geographical limitation applies.

The issue is made more complex yet, because I.R.C. § 642(c)(2) contains two clauses, one of which deals with amounts "set aside" for charity and the second of which deals with amounts "to be used exclusively" for charity. At least one court, Estate of Tait v. Commissioner, infra note 115, has indicated that although the "set aside" clause may contain a geographical limitation, the "used exclusively" clause does not. Thus, it seems that no deduction will be allowed to an estate for amounts set aside for a foreign-organized charity. (No set-aside deduction for trusts has been allowed since 1969. See, e.g., Rush v. United States, 694 F.2d 1072 (6th Cir. 1982).)

(continued...)

"Thus, an amount paid to a corporation, trust, or community chest, fund, or foundation otherwise described in section 170(c)(2) shall be considered paid for a purpose specified in section 170(c) even though the corporation, trust, or community chest, fund, or foundation is not created or organized in the United States, any State, the District of Columbia, or any possession of the United States."¹¹¹

The income tax deduction for amounts paid to charity by trusts and estates is thus not parallel to that for individuals or corporations — the former lacks what both of the latter contain: a geographical limitation on the place of organization of eligible donees.¹¹²

To analyze this disparity, a look at history should precede a look at policy.

The income tax charitable deduction was first granted to trusts and estates in 1919.¹¹³ There was no geographical restriction either as to place of organization of

(...continued)

The deduction *should* be allowed when those set-aside amounts are later "paid" to that foreign donee, but it will be useful, of course, only to the extent that there is estate income in those later years against which to offset it. (Although the deduction is measured by "any amount of the gross income, without limitation," per I.R.C. §§ 642(c)(1) and (2), the Supreme Court has held that all historic gross income — not merely gross income for the year of payment — may be considered for this purpose. Old Colony Trust Co. v. Commissioner, 301 U.S. 379 (1937). Accord, Treas. Reg. § 1.642(c)-1(a)(1). See also the last sentence of I.R.C. § 662(b).)

No further attention is paid in this article to the income tax charitable deduction for estates under I.R.C. § 642(c)(2).

111. Treas. Reg. § 1.642(c)-1(a)(2).

112. The Service has ruled, however, that no I.R.C. § 642(c) deduction is available for gifts to a foreign government or its subdivisions. Rev. Rul. 78-436, 1978-2 C.B. 187.

113. Revenue Act of 1918, Pub. L. No. 65-254, § 219(b), 40 Stat. 1057, 1071 (1919). The legislative history of the 1918 Act is altogether silent about the charitable contri-

(continued...)

the donee or as to place of use of the donated funds. The then-operative provision for individuals' income tax charitable contribution deductions was likewise free of geographical restrictions.¹¹⁴ Thus, in 1919, the rules, in this respect, were parallel. When, in 1938, geographical limitations were first imposed on the income tax charitable deduction for individuals, no such limitation was added to the deduction for trusts and estates. The negative implication — that no such limitation applied to trusts and estates — was confirmed by the Tax Court.¹¹⁵ Thus, since 1938, the rules, in this respect, have diverged.

Does this divergent treatment make sense? A good argument can be made that it does. Two examples may help:

- *Example 1:* X, a U.S. individual, gives \$100 to foreign charity C in year 1. C chooses to invest the \$100 within the United States. In years 2 and following, the passive investment income earned by C on the \$100 will be free from U.S. tax by virtue of C's exempt status.¹¹⁶

113. (...continued)

contributions deduction for trusts and estates. For thoughtful speculation about the reasons behind the provision, see SCHMOLKA, *supra* note 109, at 17-19.

114. See discussion beginning *supra* at page 6.

115. *Estate of Tait v. Commissioner*, 11 T.C. 731, 736-37 (1948), *acq.*, 1950-1 C.B. 5. More precisely, the relevant statute — § 162(a) of the Internal Revenue Code of 1939 — distinguished between amounts "set aside" for charitable purposes and amounts "used exclusively" for charitable purposes. The set-aside provisions did contain a geographical (place of organization) restriction; the used-for provisions did not.

116. A discussion of the U.S. tax treatment of C appears below in part III.A.2 of this article. Neither here nor below is there any consideration of possible reasons *other than* the I.R.C. § 501(c)(3) status of C why the income might not be taxed by the United States (e.g., it might be portfolio interest under I.R.C. § 871(h)). Of course, be-
(continued...)

- *Example 2:* X gives \$100 in trust to U.S. trustee T in year 1 for the benefit of C. In years 2 and following, T pays over to C the passive investment income earned by it on the \$100. Unless T is allowed an income tax deduction for such payments, made directly to foreign C, the U.S. will impose a tax on that income.

Thus, symmetry of tax result requires disparity of treatment of the payments to C: T should get an income tax deduction for such payments even if X is denied one. This treatment is also consistent with the U.S. taxing regime governing trusts, which attempts to treat them generally as surrogates for their ultimate beneficiaries.¹¹⁷

I.R.C. § 681

There is some bad news for trusts in I.R.C. § 681, which disallows deductions, otherwise allowable under I.R.C. § 642(c), "with respect to income of the taxable year which is allocable to [such trusts'] unrelated business income for such year." Cognoscenti of the unrelated business income tax¹¹⁸ will recall its background. The Supreme Court started the ball rolling, in 1924, by declaring that an otherwise-charitable entity could receive unrelated income from the sale of goods without losing its exempt sta-

116. (...continued)

cause of I.R.C. § 170(c)(2)(A), X will not get an income tax charitable contribution deduction for the \$100 unless the geographical restrictions can be avoided, e.g., by using a U.S. "friends of C" organization.

117. No apology is made for this generalization despite the fact that it can be shown to be quite inaccurate in many details. For an expression of a similar view, see SCHMOLKA, *supra* note 109, at 18-19.

118. The tax is imposed by I.R.C. § 511. The unrelated business income tax is sometimes referred to as the "UBIT."

tus.¹¹⁹ In a famous dictum, the Court said that the statute "says nothing about the source of the income, but makes the destination the ultimate test of exemption."¹²⁰ Many smart tax advisors kept that ball moving throughout the next two and one-half decades, helping their tax-exempt clients engage in a bewildering variety of unrelated business activities, usually without suffering the inconvenience of a federal income tax on the profits. Certainly one of the most celebrated instances — still remembered with pride and fiscal satisfaction in New York's Washington Square — was the N.Y.U. Law School macaroni factory.¹²¹ Congress perceived a problem¹²² and finally took legislative action in 1950, enacting a tax on unrelated business income of tax-exempt organizations.¹²³ The tax clearly repudiated, in part, the so-called destination test of the Supreme Court's 1924 dictum.

The income tax deduction for charitable contributions, however, is simply the destination test, which in that form survived the 1950 legislation, is in vigorous health, and is not affected by the UBIT. Thus, if an individual, rather than the N.Y.U. Law School, owns a macaroni factory as a sole proprietor and donates its profits to the Law

119. Trinidad v. Sagrada Orden de Predicadores, 263 U.S. 578 (1924).

120. 263 U.S. at 581.

121. C.F. Mueller Co. v. Commissioner, 14 T.C. 922 (1950), rev'd, 190 F.2d 120 (3d Cir. 1951). For details, see John Brooks, The Marts of Trade: The Law School and the Noodle Factory, THE NEW YORKER, Dec. 26, 1977, at 48.

122. During the 1950 debates, Representative Dingell referred to the risk that "all the noodles produced in this country will be produced by corporations held or created by universities" REVENUE REVISION OF 1950: HEARINGS BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS, 81st Cong., 2d Sess. 579-80 (1950).

123. Revenue Act of 1950, Pub. L. No. 814, § 301(a). For a quite useful survey, see Kenneth C. Eliasberg, Charity and Commerce: Section 501(c)(3) — How Much Unrelated Business Activity?, 21 TAX L. REV. 53 (1965).

School, the profits are never taxed — subject, of course, to the applicable limitations on deductibility.¹²⁴

But for these limitations, and the certainty of mortality, the 1950 UBIT legislation could be completely de-fanged through the charitable contribution deduction. A moment's contemplation will demonstrate that I.R.C. § 642(c) offers a way around both problems: an individual could give the macaroni factory to a trust which in turn would pay over the profits to the Law School.¹²⁵ Because the trust's deduction would *not* be limited,¹²⁶ and the trust might never die,¹²⁷ this structure would sound the death knell for the UBIT. It is clear, then, that I.R.C. § 681 is necessary if the UBIT is to be taken seriously.

One aspect of I.R.C. § 681 is clear: the deduction is cut back to *some* extent if the gift is allocable to the trust's unrelated business income.¹²⁸ What is unclear, on the face of the Code, is whether the deduction is altogether lost or, if not, is only permitted subject to other limitations. The regulations answer the first question unambiguously, stating that, despite the applicability of I.R.C. § 681, "a partial deduction is

124. The limit generally is 50 percent of the taxpayer's "contribution base," per I.R.C. § 170(b)(1)(A). The quoted term is defined as "adjusted gross income (computed without regard to any net operating loss carryback . . .)." I.R.C. § 170(a)(1)(F).

125. We will ignore, for present purposes, the risk that such a trust would be treated as an association taxable as a corporation. See *infra* note 134.

126. As we have previously noted, the deduction under I.R.C. § 642(c) applies to "any amount of the gross income, without limitation."

127. The Rule Against Perpetuities may be avoidable either because of the charitable nature of the beneficiary or because some jurisdictions do not have one. Even if it does apply, careful choice of measuring lives makes possible quite extended terms for trusts subject to the Rule.

128. See also Treas. Reg. § 1.642(c)-3(d).

nevertheless allowed for such amounts by the operation of section 512(b)(11).¹²⁹

That section reads:

"[T]he deduction allowed by section 170 (relating to charitable etc. contributions and gifts) shall be allowed (whether or not directly connected with the carrying on of the trade or business), and for such purpose a distribution made by the trust to a beneficiary described in section 170 shall be considered as a gift or contribution. The deduction allowed by this paragraph shall be allowed with the limitations prescribed in section 170(b)(1)(A) and (B) determined with reference to the unrelated business taxable income computed without the benefit of this paragraph (in lieu of with reference to adjusted gross income)."

It dimly appears that the partial deduction is subject to at least certain limitations. Translating some of the opaque statutory cross references, the regulations elucidate:

"The partial deduction is subject to the percentage limitations applicable to contributions by an individual under section 170(b)(1)(A) and (B), and is not allowed for amounts set aside or to be used for charitable purposes but not actually paid out during the taxable year."¹³⁰

Several points emerge: (1) the I.R.C. § 642(c) deduction recedes in favor of an I.R.C. § 170 deduction when the UBIT applies; (2) the latter deduction is limited to the 50 percent or 30 percent limitations for individuals, but applied to unrelated business income rather than adjusted gross income; and (3) the deduction is only available for amounts actually paid to charity during the year.

The one issue of most interest here, however, is not resolved: is the partial deduction available for gifts made directly to a foreign-organized charity? The statute and the regulations provide no clear answer, and no other authority could be found. Although the outcome is thus uncertain, the more likely (if not the wiser) answer is that such a deduction is *not* permitted. The partial deduction granted by I.R.C. §

129. Treas. Reg. § 1.681(a)-2(a).

130. Treas. Reg. § 1.681(a)-2(a).

512(b)(11) refers to "the deduction allowed by section 170," which, as we well know, contains a clear place-of-organization restriction.¹³¹ This produces a curious result: in the absence of unrelated business income, a trust's charitable contribution deduction is not geographically restricted; in the presence of such income, however, it is.

A final observation: I.R.C. § 681 primarily affects those few types of unrelated business income — such as unrelated debt-financed income¹³² — that may be generated without the actual conduct of a trade or business. Although most sorts of unrelated business income derive from a trade or business,¹³³ a trust generating such income is

131. I.R.C. § 170(c)(2)(A).

132. I.R.C. § 514. The tainted income may be derived directly or by a partnership in which the trust is a partner. See also I.R.C. § 512(b)(13), dealing with certain types of income received by an exempt organization from a "controlled organization."

133. See I.R.C. §§ 512 and 513 generally.

in some danger of transmogrifying into an association taxable as a corporation,¹³⁴ in which case § 681 would cease to apply to it.

D. Private Foundations. Because domestic private foundations are exempt from taxation,¹³⁵ the deductibility of their grants, gifts, or donations is not an issue. Private foundations do have other tax concerns, however, that affect their ability to make grants to foreign charities.

134. Unrelated business income generally derives from "any unrelated trade or business . . . regularly carried on . . ." I.R.C. § 512(a)(1). For this purpose, the I.R.C. § 513(a) definition of "unrelated trade or business" adopts the I.R.C. § 162 definition of "trade or business." Treas. Reg. § 1.513-1(b). Trusts which engage in a trade or business are at risk of being treated as associations. See, e.g., Joseph V. Sliskovich & Stewart S. Karlinsky, Tax Classification of Trusts: The Howard Case and Other Current Developments, 19 LOYOLA L.A.L. REV. 803 (1986); Colleen J. Doolin, Note, Determining the Taxable Status of Trusts That Run Businesses, 70 CORNELL L. REV. 1143 (1985). The risk is not a certainty, however. See, e.g., Harry M. Bedell, Jr. v. Commissioner, 86 T.C. 1207 (1986), acq., 1987-2 C.B. 1, allowing a testamentary trust to continue a manufacturing business for more than 15 years without becoming an association. See also Elm Street Realty Trust v. Commissioner, 76 T.C. 803 (1981), acq., 1981-2 C.B. 1, and Water Resource Control v. Commissioner, 61 T.C.M. 2102, 2114-16 (1991). Although the Service acquiesced in Bedell, the IRS does not like its result. A.O.D. 1987-001 (June 15, 1987), discussing the Bedell case, concluded: "The decision is factual in nature and not clearly erroneous. While appeal is not warranted here, we will consider on a case by case basis whether testamentary trusts can be classified as associations in other instances." The Code itself contemplates that an entity may be a trust while generating "unrelated trade or business" income. I.R.C. § 513(b). I.R.C. § 875(2) treats a foreign person who is a trust beneficiary as engaged in a U.S. business if the trust itself is so engaged. The Code and regulations explicitly confirm that estates and trusts may have net operating losses. I.R.C. § 642(d); Treas. Reg. § 1.642(d)-1. See also Treas. Reg. § 1.652(b)-3(a), stating that, in the determination of distributable net income, "all expenditures directly attributable to a business carried on by a trust are allocated to the income from such business."

135. All private foundations are, by definition, § 501(c)(3) organizations. See I.R.C. § 509(a).

Private foundations are subject to the rules of subchapter A of chapter 42 of the Code,¹³⁶ which were added to the Code in 1969. Among other requirements, private foundations must meet certain distribution-of-income rules to avoid penalty taxes.¹³⁷ In general, they must make annual "qualifying distributions" in an amount equal to 5% of their net assets.¹³⁸ "Qualifying distributions" include amounts "paid to accomplish one or more purposes described in § 170(c)(2)(B)"¹³⁹ but generally do *not* include amounts paid to a non-operating private foundation.¹⁴⁰ Thus, a private foundation must determine (1) whether its grants are paid for § 170(c)(2)(B) purposes and (2) whether the donee is a non-operating private foundation. As to the first test, it should make no difference to the U.S. private foundation whether a grant is being made to a domestic or a foreign donee.¹⁴¹

The second test, however, imposes a special burden on a U.S. foundation making grants to a foreign charity: determining whether the foreign charity is a non-oper-

136. This comprises I.R.C. §§ 4940-48.

137. I.R.C. § 4942.

138. *Id.* This is a quite substantial over-simplification. For details, see BRUCE R. HOPKINS, *THE LAW OF TAX-EXEMPT ORGANIZATIONS* 458-75 (6th ed. 1992); IRC 4942(g) — Qualifying Distributions, EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION TECHNICAL INSTRUCTION PROGRAM FOR 1988 39 (1988).

139. I.R.C. § 4942(g)(1)(A).

140. I.R.C. § 4942(g)(1)(A)(ii). There is an exception for amounts paid to a non-operating private foundation if that donee, in turn, passes through the amounts it receives, in what would be a "qualifying distribution," within one year. I.R.C. § 4942(g)(3).

141. As a practical matter, it may be more difficult in some cases to determine how a foreign donee uses the grant than to determine how a domestic donee uses it.

ating private foundation. The regulations make clear that the U.S. donor is not prevented from making a grant merely because the foreign charity has not applied for and received a determination letter from the Service establishing its status. Instead, they require the distributing U.S. foundation to make its own "good faith determination" of the donee organization's status.¹⁴² The regulations explain that the:

"'good faith determination' ordinarily will be considered as made where the determination is based on an affidavit of the donee organization or an opinion of counsel (of the distributing foundation or the donee organization) that the donee is an organization described in section 509(a) (1), (2), or (3) or 4942(j)(3). Such an affidavit or opinion must set forth sufficient facts concerning the operations and support of the donee organization for the Internal Revenue Service to determine that the donee organization would be likely to qualify as an organization described in section 509(a) (1), (2), or (3) or 4942(j)(3)."¹⁴³

For many years, that was the state of the law. Private foundations had to make such good faith determinations whenever considering grants to foreign charities. No private foundation could rely on the good faith determination of another private foundation, even as to the same foreign donee. Furthermore, the details of compliance with the good-faith standard proved to be complex, time-consuming, and expensive.¹⁴⁴

142. Treas. Reg. § 53.4942(a)-3(a)(6)(i) provides:

"Distributions for purposes described in section 170(c)(2)(B) to a foreign organization, which has not received a ruling or determination letter that it is an organization described in section 509(a) (1), (2), or (3) or 4942(j)(3), will be treated as a distribution made to an organization described in section 509(a) (1), (2), or (3) or 4942(j)(3) if the distributing foundation has made a good faith determination that the donee organization is an organization described in section 509(a) (1), (2), or (3) or 4942(j)(3)."

143. Id.

144. For a discussion of the difficulties, see Michael I. Sanders, Support and Con-
(continued...)

The "taxable expenditures" rules, set forth in I.R.C. § 4945(d), impose similar burdens on U.S. private foundations making grants to foreign charities. Section 4945(d)(4) defines as a "taxable expenditure," subject to penalty taxes, any grant made by a private foundation unless:

"(A) such [donee] organization is described in paragraph (1), (2), or (3) of section 509(a) or is an exempt operating foundation (as defined in section 4940(d)(2)), or

"(B) the private foundation exercises expenditure responsibility with respect to such grant in accordance with subsection (h) . . .

In addition, I.R.C. § 4945(d)(5) treats as a "taxable expenditure" any grant made "for any purpose other than one specified in section 170(c)(2)(B)."

The regulations provide two separate tests to guide the domestic foundation in making the relevant determinations:

1. With respect to expenditures described in I.R.C. § 4945(d)(4), the private foundation can make a "good faith determination that the grantee organization is an organization described in section 509(a)(1), (2), or (3)."¹⁴⁵

(...continued)

duct of Charitable Operations Abroad, 1 NOTRE DAME INST. ON CHARIT. GIVING, FOUNDATIONS, & TRUSTS 33, 42-45 (1976).

145. Treas. Reg. § 53.4945-5(a)(5). Although the regulation does not mention I.R.C. § 4940(d)(2), that is because the statute was amended to add that section — defining "exempt operating foundation" — after the regulation had already been adopted. The IRS will apply the regulation, nevertheless, to the § 4940(d)(2) determination. IRS CPE '92, supra note 34, at 241. In LTR 8508109 (Nov. 30, 1984), the Service confirmed that if a domestic foundation properly satisfied itself, under the regulation, that its foreign donee was not a private foundation, it would be relieved of expenditure responsibility. The precise language of LTR 8508109 is: "In addition, M [the U.S. private foundation donor] may not have to exert 'expenditure responsibility' if it satisfies the special requirements for grants to foreign organizations that are public charities, such

(continued...)

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2. With respect to expenditures described in I.R.C. § 4945(d)(5), the private foundation is protected if the donee is a § 501(c)(3) organization.¹⁴⁶ In the case of a foreign donee, the domestic foundation may make a "reasonable judgment . . . [that] the grantee organization is an organization described in section 501(c)(3)"

The good faith determination is made in virtually the same manner as for the qualifying distribution test.¹⁴⁷ And, as in the case of qualifying-distribution determinations,

(...continued)

as section 170(b)(1)(A)(ii) organizations, without having rulings from the Service to that effect. See section 53.4945-5(a)(5) of the regulations." Of course, if the private foundation fails to satisfy the requirements of the regulation, it will not be protected. Thorne v. Commissioner, 99 T.C. 67, 101-03 (1992). For purposes of the I.R.C. § 170(b)(1)(A)(vi) support test, the Service has ruled that foreign government support constitutes support from a government. Rev. Rul. 75-435, 1975-2 C.B. 215. Although G.C.M. 38327 (March 31, 1980) tentatively recommended revoking that ruling, it remains in force. See, e.g., LTR 8515070 (Jan. 15, 1985).

146. Treas. Reg. § 53.4945-6(c)(2)(i) protects the donor if *either* it makes the grants to a § 501(c)(3) organization (other than one testing for public safety) *or* it "is reasonably assured" that the grant will be used for § 170(c)(2)(B) purposes and it undertakes to maintain the grant in a separate fund and it complies with the expenditure responsibility provisions. Note that the status of the donee as a § 501(c)(3) organization relieves the donor of all of the more rigorous policing rules. In transmitting the Treasury Decision dealing with these regulations, while still in proposed form, the Commissioner of Internal Revenue wrote to the Assistant Secretary of the Treasury: "However, it appears to be an unreasonable administrative burden on the Service as well as the foreign organizations to require such organizations to obtain rulings or determination letters in situations where their only connection with the United States might be as recipient of a grant from a United States private foundation." The final regulations were promulgated by T.D. 7233, 1973-1 C.B. 235 (Oct. 4, 1972).

147. Treas. Reg. § 53.4945-5(a)(5) uses almost identical language to Treas. Reg. § 53.4942-3(a)(6), quoted supra at p. 44.

the burdens of complying with the taxable-expenditure determinations — whether based on good faith or reasonable judgment — were substantial.

After several years of effort, the Service and the foundation community worked out a simplified method of compliance. In Rev. Proc. 92-94,¹⁴⁸ the Service removed most — but not quite all — of the relevant thorns from the feet of U.S. private foundations.¹⁴⁹ The revenue procedure applies:

"if the grant is made by a domestic private foundation to a foreign organization that does not have an Internal Revenue Service ruling letter recognizing its exemption under section 501(c)(3), or classifying it as a public charity under section 509(a)(1), (2), or (3), or as a private operating foundation under section

A domestic private foundation that follows the requirements of the Revenue Procedure will be protected against the imposition of excise taxes under both I.R.C. §§ 4942 and 4945:

"If the requirements of this revenue procedure are met, a grant to a foreign grantee will be treated as a grant to an organization that is described in section 501(c)(3) or section 4947(a)(1) of the Internal Revenue Code, and, that is either a public charity within the meaning of section 509(a)(1), (2), or (3), or a private operating foundation under section 4942(j)(3) of the Code."¹⁵¹

148. 1992-2 C.B. 507. Because of its special importance to the topic of this article, the full text of Rev. Proc. 92-94 is attached as Appendix B beginning at page 77 *infra*.

149. For a general discussions, see Deborah M. Beers, Charitable Contributions for Foreign Use and Private Foundation Grants to Foreign Charities: Rev. Proc. 92-94, 34 TAX MGMT. MEM. 83 (1993); Mark B. Weinberg & Peter C. Wolk, IRS "Simplifies" Procedures for Private Foundation Grants to Foreign Entities, 5 J. TAX'N OF EXEMPT ORGANIZATIONS 59 (1993).

150. Rev. Proc. 92-94, 1992-2 C.B. 507, § 3.

151. Rev. Proc. 92-94, 1992-2 C.B. 507, § 1.

Rev. Proc. 92-94 allows both the reasonable judgment and good faith determinations to be made based on a "currently qualified affidavit" from the grantee.¹⁵² The affidavit need not have been prepared for the particular U.S. donor; thus, once a proper affidavit has been executed, it will, so long as it remains "currently qualified," protect all domestic private foundations making grants to the same foreign charity. In general, an affidavit will be "currently qualified" as to non-financial data so long as the underlying facts have not changed.¹⁵³ If, however, financial data are important, e.g., because the foreign grantee needs to demonstrate widespread public support for purposes of avoiding private foundation status,¹⁵⁴ the affidavit will only be "currently qualified" if it reflects the grantee's "latest complete accounting year."¹⁵⁵

The exact language of one acceptable form of the affidavit is set out in full in the Revenue Procedure,¹⁵⁶ albeit variations are permitted.¹⁵⁷

Although Rev. Proc. 92-94 significantly eases the burdens of U.S. private foundations interested in international grant making, it does not completely eliminate them.¹⁵⁸ In addition to the "currently qualified affidavit" requirement, certain other

152. *Id.*, § 4.01.

153. *Id.*, § 4.04. "[A]n attested statement by the grantee to that effect is enough to update an affidavit." *Id.*

154. Under I.R.C. § 509(a)(2) or, via I.R.C. § 509(a)(1), under I.R.C. § 170(b)(1)(A)(vi).

155. Rev. Proc. 92-94, 1992-2 C.B. 507, § 4.03. But see *id.*, § 4.05.

156. *Id.*, § 5.04.

157. *Id.*, § 5.01.

158. For example, LTR 9505017 (Nov. 7, 1994), confirms that a U.S. private founda-
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tests must be met. *First*, not surprisingly, the affidavit may not protect a donor with actual knowledge that it is unreliable.¹⁵⁹ *Second*, foreign schools must comply with U.S. standards for racial nondiscrimination.¹⁶⁰ This second requirement was ratified, for domestic schools, by the Supreme Court in Bob Jones University v. United States,¹⁶¹ and has created some interesting problems — discussed below¹⁶² — in its application to foreign circumstances.

E. Public Charities. Because they are not subject to any of the chapter 42 restrictions, public charities¹⁶³ making contributions to foreign charities have a much

158. (...continued)
tion must shoulder extra burdens in making grants to foreign charities which, although complying with Rev. Proc. 92-94, have not applied for determination letters from the Internal Revenue Service confirming their charitable status. The ruling states:

"Because you are making grants to foreign organizations which do not have ruling or determination letters, additional requirements must be met to ensure that your grants will be treated as qualifying distributions for the purposes of section 4942 and not taxable expenditures within the meaning of section 4945(d). In order to satisfy these requirements you have established certain procedures to permit you to control your grants to ensure that funds are expended to accomplish the intended goals. In addition, have indicated that you will comply with the requirements set forth in Rev. Proc. 92-94."

159. *Id.*, § 4.01. The language of § 4.01, however, only says that the grantor "must consider" such information; it does not automatically deny reliance on the affidavit.

160. *Id.*, § 5.03. See also *id.*, ¶ (13) of the affidavit prescribed in § 5.04.

161. 461 U.S. 574 (1983).

162. See text accompanying notes 176 - 194, *infra*.

163. The phrase "public charities" is used in this article to describe I.R.C. § 501(c)(3)
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easier row to hoe than do private foundations.¹⁶⁴ Nevertheless, even public charities have important concerns about the charitable status of foreign donees.

For example, if a foreign donee does qualify under § 501(c)(3) standards,¹⁶⁵ the domestic public charity may make donations to it without requiring any accounting.¹⁶⁶

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organizations which are not private foundations under I.R.C. § 509(a).

164. For this and many other more important reasons, it is often desirable to escape private foundation classification. The Service has ruled that a U.S. charity may avoid private foundation status by becoming a "supporting organization," under I.R.C. § 509(a)(3), for a foreign charity. Rev. Rul. 74-229, 1974-1 C.B. 142. In order to qualify under § 509(a)(3), the supporting organization must meet one of three tests, each designed to show that it is controlled by and responsive to the needs of the supported § 501(c)(3) entity. See generally Treas. Reg. § 1.509(a)-4. For example, those regulations state that the supporting organization's relationship with the supported entity "is comparable to that of a parent and subsidiary, where the subsidiary is under the direction of, and accountable or responsible to, the parent organization." Treas. Reg. § 1.509(a)-4(g)(1)(i). Given this degree of domination, it is interesting that the Service published Rev. Rul. 74-229, *supra*. As discussed in the text accompanying notes 33 - 36, *supra*, the Service has been worried about the deductibility of gifts to a U.S. charity which, without a proper amount of discretion and control, passes the funds on to a foreign charity. For a discussion of Rev. Rul. 74-229 and the tensions created by these opposed policies, see IRS CPE '92, *supra* note 34, at 238-39; Kimberly S. Blanchard, U.S. Taxation of Foreign Charities, 8 EXEMPT ORG. TAX REV. 719, 724-25 (1993).

165. This would include both foreign private foundations and foreign public charities.

166. Thus, Rev. Rul. 67-149, 1967-1 C.B. 133, holds that a domestic organization is exempt when "it carries on no operations other than to receive contributions and incidental investment income and to make distributions of income to such exempt organizations at periodic intervals." The ruling contains no requirement of policing the use of the distributions by the donees. It restates an older precedent to the same effect: I.T. 1945, III-1 C.B. 273 (1924). As discussed *supra* note 145, U.S. private foundations are relieved of expenditure responsibility in making gifts to foreign donees which are

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If the foreign donee does *not* so qualify, however, the domestic public charity would risk its own exemption if it transferred funds to the donee without verifying that the foreign donee used them for § 501(c)(3) purposes.¹⁶⁷ As a recent Service publication puts it:

"[I]f a domestic organization, otherwise qualified under IRC 501(c)(3), transmits its funds to a private organization not described in IRC 501(c)(3) and fails to exercise, or has too little, discretion and control over the use of such funds to assure their use exclusively for charitable purposes, the domestic organization forfeits its qualification for exempt status because it cannot demonstrate that it is operated exclusively for charitable purposes, and contributions to it are not deductible."¹⁶⁸

Thus, providing funds only to foreign donees that meet I.R.C. § 501(c)(3) standards, i.e., that satisfy the so-called "foreign equivalency" test, may spare U.S. public charities from a § 501(c)(3) version of expenditure responsibility.¹⁶⁹ However, the regulations

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not private foundations; it would make no sense to impose a different and higher standard on U.S. public charities making such gifts.

167. Rev. Rul. 68-489, 1968-2 C.B. 210, clearly implies that failure to impose such procedures would "jeopardize the [donor] organization's exemption under section 501(c)(3) of the Code."

168. IRS CPE '92, supra note 34, at 233.

169. It is not intended, here, to use the phrase "expenditure responsibility" in its strict sense, i.e., in the sense in which it applies to certain grants by private foundations under I.R.C. §§ 4945(d)(4)(B) and 4945(h), and Treas. Reg. §§ 53.4945-5(b) through (e) (about six pages of regulations).

prescribe no good-faith or reasonable-judgment standards for making such determinations, and Rev. Proc. 92-94 provides no direct assistance.¹⁷⁰

III. Treatment of Foreign Charities

A. In General.

1. **Tax-Exempt Status.** Section 501(c)(3) contains no geographical restrictions.¹⁷¹ It is clear beyond question that foreign-organized entities may qualify under that paragraph. The Service has explicitly confirmed this in Rev. Rul. 66-177,¹⁷² which reads, in its entirety:

"The fact that an organization has been formed under foreign law will not preclude its qualification as an exempt organization under section 501(a) of the Internal Revenue Code of 1954 if it meets the tests for exemption under that section."

Two questions remain: (1) how are U.S. standards for charitable status applied to foreign organizations, and (2) what procedural requirements, if any, affect foreign entities desiring so to qualify?

The first question has several interesting answers. The Service generally applies all relevant U.S. standards for § 501(c)(3) status to foreign entities. Thus, for example, they must be both organized and operated for charitable purposes.¹⁷³ The former sometimes causes difficulties for foreign organizations that, for example, do not rou-

170. Of course, counsel for public charities may attempt to rely on Rev. Proc. 92-94 as a useful analogy for their clients. By its own terms, however, the Rev. Proc. does not apply unless "the grant is made by a domestic private foundation" Rev. Proc. 92-94, 1992-2 C.B. 507, § 3.

171. Some of the other paragraphs of I.R.C. § 501(c) *do* contain geographical limitations, e.g., I.R.C. §§ 501(c)(1), (19), (21), and (22).

172. 1966-1 C.B. 132.

173. I.R.C. § 501(c)(3) and Treas. Reg. § 1.501(c)(3)-1(a)(1).

tinely put provisions in their "articles" for the proper charitable treatment of their assets on dissolution.¹⁷⁴ Furthermore, the legal restrictions on inurement, private benefit, excessive lobbying, and political campaign activities are all applicable to foreign entities.¹⁷⁵

The Service also applies the Bob Jones public policy notions¹⁷⁶ to foreign organizations.¹⁷⁷ Thus, foreign "schools"¹⁷⁸ are expected to comply with Rev. Proc. 75-

174. Such restrictions are required by Treas. Reg. § 1.501(c)(3)-1(b)(4). The Service takes such a mechanically strict view of it that it has challenged the exemption of an organization which, while having the appropriate provisions in its by-laws, did not also include them within its "articles." Colorado State Chiropractic Society, 93 T.C. 487 (1989). Happily the Service lost the case.

175. IRS CPE '92, supra note 34, at 233-34. The Service has ruled that foreign laws are "legislation" for purposes of I.R.C. § 501(c)(3). Rev. Rul. 73-440, 1973-2 C.B. 17. The ruling was cited with approval in H.R. Rep. No. 94-1210, 94th Cong., 2d Sess. n. 4 (1976), reprinted at 1976-3 C.B. (Vol. 3) 40. For a discussion of the scope of ruling as applied to an organization concerned with international human rights emigration issues, see G.C.M. 37741 (Nov. 9, 1978).

176. The leading case is Bob Jones Univ. v. United States, 461 U.S. 574 (1983), held, as a matter of statutory construction, that all I.R.C. § 501(c)(3) organizations must meet common-law charitable standards, including compliance with "public policy." The decision came more than a decade *after* the U.S. Supreme Court to deal with the core issue: racial discrimination in education. See, United States v. Carolene Products Co., 309 F. Supp. 1127 (D.D.C.), appeal dismissed sub nom. Carolene Products Co. v. United States, 461 U.S. 956 (1970), preliminarily enjoining the IRS from granting tax-exempt status to racially-discriminatory private schools in Mississippi. Some of the pronouncements also preceded the Bob Jones decision, including Rev. Proc. 75-50, 1975-2 C.B. 587, discussed below.

177. For example, a recent training text reads, "It is not sufficient that an activity is not a prohibited activity or activities that are contrary to public policy under I.R.C. § 501(c)(3) exempt status regardless of the locus of the activity." supra note 34, at 234. This was not the original view of the Service (1976), says, "In our judgment, however, it cannot

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50,¹⁷⁹ which requires every school to "show affirmatively both that it has adopted a racially nondiscriminatory policy as to students that is made known to the general public and that since the adoption of that policy it has operated in a bona fide manner in accordance therewith."¹⁸⁰ More specifically, each school must include an appropriate nondiscriminatory statement "in its charter, bylaws, or other governing instrument, or in a resolution of its governing body";¹⁸¹ include a similar statement "in all its brochures and catalogs dealing with student admissions, programs, and scholar-

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tions of this private school in [a foreign country] would necessarily have to conform to the public policy of the United States that was the basis for the result reached in Rev. Rul. 71-447." G.C.M. 36930 (Nov. 24, 1976), squarely holds the "[t]he procedural and record-keeping requirements of Rev. Proc. 75-50 should not be treated as applicable to private schools whose operations are confined to foreign lands." In G.C.M. 37867 (Feb. 27, 1979), however, the Service changed its position, holding that "there is now sufficient authority for the public policy expressed in Rev. Rul. 71-447 to be applicable to foreign schools, and to the extent that G.C.M. 36885 is inconsistent with this interpretation, it is hereby modified." In the same 1979 G.C.M., the Service revoked G.C.M. 36930, saying "G.C.M. [36930] employed the reasoning that Rev. Proc. 75-50 was occasioned by a unique domestic situation and that compliance with Rev. Proc. 75-50 would be unduly burdensome to foreign schools. This reasoning is inconsistent with this memorandum and, accordingly, G.C.M. 36930 is hereby revoked."

178. For this purpose, "school" has the same meaning as it has in I.R.C. § 170(b)(1)(A)(ii), per § 3.04 of Rev. Proc. 75-50, 1975-2 C.B. 587. That section of the Code reads: "an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on." The relevant regulations confirm that this includes "primary, secondary, preparatory, or high schools, and colleges and universities." Treas. Reg. § 1.170A-9(b)(1).

179. 1975-2 C.B. 587.

180. *Id.*, § 2.02.

181. *Id.*, § 4.01.

ships";¹⁸² publicize its policy in "a newspaper of general circulation that serves all racial segments of the community" or via "the broadcast media . . . if this use makes such nondiscriminatory policy known to all segments of the general community . . .";¹⁸³ and take certain other steps.¹⁸⁴ Each school "must certify annually, under penalties of perjury . . . that . . . the school has satisfied the applicable requirements of . . . this Revenue Procedure."¹⁸⁵

Clearly, few foreign schools comply with these requirements. The Service sometimes has been willing to waive some or all of them. For example,¹⁸⁶ the Service confirmed the tax-exempt status of several foreign schools despite their non-compliance with various portions of Rev. Proc. 75-50, when each in fact had a racially-nondiscriminatory policy, local law made it potentially illegal to maintain statistics by race, and their student bodies were racially mixed.¹⁸⁷ The Service first stated that "the declared Federal policy against racial discrimination in education . . . is applicable to the

182. *Id.*, § 4.02.

183. *Id.*, § 4.03. There are exceptions to this requirement which are too detailed to describe here.

184. See, e.g., *id.*, §§ 4.04, 4.05, and 4.07.

185. *Id.*, § 4.06.

186. In addition to the following authority, and precedents referred to in it, the Service earlier had considered the tax-exempt status of an all-black school, which did not admit whites, located in South Africa. It held the school to be tax-exempt in G.C.M. 36885 (Oct. 6, 1976). See also G.C.M. 36930 (Nov. 24, 1976). G.C.M. 37867 (Feb. 27, 1979), disagreed with and modified some of the reasoning in each of the memoranda cited in this footnote.

187. G.C.M. 37867 (Feb. 27, 1979).

subject foreign schools in the determination of their exempt status."¹⁸⁸ It then analyzed the submissions of the foreign schools, including their statements that some of the Rev. Proc. 75-50 requirements would be illegal, unusual, embarrassing, or inappropriate in their respective circumstances. It concluded:

"We do recognize, however, that situations may arise where foreign law or practice may render compliance with certain provisions of Rev. Proc. 75-50 illegal or impractical in a particular country. In those cases, compliance with the provisions of Rev. Proc. 75-50 giving rise to the illegality or impracticality may be excused, but only after a showing by the foreign school of a reasonable basis for excusing compliance. The burden is on the organization to show such a reasonable basis."¹⁸⁹

This flexibility is reflected in Rev. Proc. 92-94, which permits the foreign charity's "currently qualified affidavit" to "explain any basis for the grantee school's failure to comply with one or more of the provisions of Rev. Proc. 75-50" ¹⁹⁰

If a foreign organization, otherwise qualified under I.R.C. § 501(c)(3), violates some provision of *foreign law*, e.g., a law requiring racial segregation, will that impact its U.S. tax status? It is clear that violations of *U.S. law* will result in loss of tax exemption,¹⁹¹ at least if the violations are not inadvertent and the law in question is not

188. Id.

189. Id. (footnote omitted).

190. Rev. Proc 92-94, 1992-2 C.B. 507, § 5.03. See generally Robert H.M. Ferguson & Laura E. Butzel, What Alternatives are Available to Foreign Schools for Satisfying Nondiscrimination Guidelines?, 5 J. TAX'N EXEMPT ORG'S 64 (1993).

191. E.g., Church of Scientology of California, 83 T.C. 381 (1984), aff'd on other grounds, 823 F.2d 1310 (9th Cir. 1987), cert. denied, 486 U.S. 1015 (1988) (organization engaged in a conspiratorial effort to falsify records, steal information from the IRS, and prevent the Service from properly auditing it); Synanon Church v. United States, 579 F. Supp. 967 (D.D.C. 1984), aff'd, 820 F.2d 421 (D.C. Cir. 1987) (Synanon officials had destroyed evidence relevant to the determination of its tax-exempt status, (continued...))

merely "regulatory."¹⁹² This is true even if the violations occur outside of the U.S.¹⁹³ However, there is no authority bearing on an organization's ability to continue to qualify under § 501(c)(3) if the violation relates only to a provision of *foreign* law. The IRS has called this an open question and has directed that any such issue be brought to the National Office for technical advice.¹⁹⁴

The Service has been inconsistent about whether foreign charities need to apply for recognition of their exempt status. For domestic charities, the rules are straightforward. With exceptions not here relevant,¹⁹⁵ I.R.C. § 508(a) requires an organization to

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including its alleged advocacy of violence and deflection of funds to private persons); Rev. Rul. 75-384, 1975-2 C.B. 204 (anti-war group encouraged its members and others to engage in civil disobedience to further the group's purposes). Rev. Rul. 75-384 is supported by G.C.M. 36153 (Jan. 31, 1975).

192. Rev. Rul. 75-384, 1975-2 C.B. 204, revoking the exemption of an organization which advocated civil disobedience, carefully states:

"In this case the organization induces or encourages the commission of criminal acts by planning and sponsoring such events. The intentional nature of this encouragement precludes the possibility that the organization might unfairly fail to qualify for exemption due to an isolated or inadvertent violation of a regulatory statute."

193. This is clearly demonstrated by the Service's application of Rev. Proc. 75-50 to foreign schools.

194. IRS CPE '92, supra note 34, at 234.

195. See I.R.C. § 508(c). This subsection excepts from the notification requirement (1) "churches, their integrated auxiliaries, and conventions or associations of churches," and (2) organizations, other than private foundations, whose gross receipts normally do not exceed \$5,000. In addition, by regulation (specifically authorized by I.R.C. § 508(c)(2)), exceptions are provided (i) for "subordinate organizations (other than private foundations) covered by a group exemption letter" (Treas. Reg. § 1.508-

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apply to the Service, within 27 months of its organization, for recognition of charitable status.¹⁹⁶ The statute provides two apparent sanctions for failure to comply with this notice requirement: the offending charity "shall not be treated as an organization described in section 501(c)(3)"¹⁹⁷ and donors to it will be denied a charitable contribution deduction.¹⁹⁸ Because donors to foreign charities are denied such deductions in any event,¹⁹⁹ only the first sanction appears to threaten foreign charities.

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1(a)(3)(i)(c)), (ii) for certain charitable trusts (Treas. Reg. § 1.508-1(a)(3)(d)), and (iii) for "[a]ny other class of organization that the Commissioner from time to time excludes from the requirement . . . (Treas. Reg. § 1.508-1(a)(3)(e)).

196. I.R.C. § 508(a)(1) says the notice shall be given "in such manner as the Secretary may by regulations prescribe." Treas. Reg. § 1.508-1(a)(2)(i) prescribes the use of a Form 1023, and states that it must be filed within 15 months from the end of the month of organization. Section 4.01 of Rev. Proc. 92-85, 1992-2 C.B. 490, grants an automatic 12-month extension of this time period.

197. I.R.C. § 508(a). The regulations confirm the statutory language. Treas. Reg. § 1.508-1(a)(1). The Service has ruled accordingly. Rev. Rul. 77-207, 1977-1 C.B. 152; Rev. Rul. 77-208, 1977-1 C.B. 153.

198. I.R.C. § 508(d)(2)(B).

199. I.R.C. § 170(c)(2)(A). Further, the deduction under I.R.C. § 642(c)(1) does not depend upon the donee qualifying under I.R.C. § 501(c)(3); rather, the former paragraph refers to I.R.C. § 170(c) (but exclusive of the place-of-organization limitation) for a description of the qualifying donee, and there is no notification requirement in I.R.C. § 170(c). The gift and estate tax charitable deductions also contain their own descriptions of eligible donees which do not depend, in general, on the donee qualifying under I.R.C. § 501(c)(3), and which contain no notification requirement. The only explicit cross-reference to I.R.C. § 501(c)(3) is for the narrow purpose of borrowing the rules limiting lobbying activities, which should be read to strengthen the general rule that qualification under I.R.C. § 501(c)(3) is not relevant for gift and estate tax purposes. I.R.C. §§ 2055(a)(2) and(3), 2522(a)(2).

For several reasons, however, the apparent threat is illusory. First, the Service encourages tardy charities to apply for I.R.C. § 501(c)(4) status to cover the earlier period, and routinely grants such applications.²⁰⁰ In most cases, § 501(c)(4) status provides exactly the same tax-exempt benefits to the entity as § 501(c)(3). Furthermore, in the instances in which § 501(c)(4) status is *not* identical — e.g., where the organization has outstanding § 103 bonds, or would become liable for state sales taxes, or has been contracting with state or local governments under rules requiring § 501(c)(3) status — the Service sometimes has been willing to grant § 501(c)(3) status retroactively,²⁰¹ notwithstanding the charity's failure to file the notice in a timely fashion.

The Code itself exempts most foreign organizations from filing a notice. I.R.C. § 4948(b) reads:

"Section 507 (relating to termination of private foundation status), section 508 (relating to special rules with respect to section 501(c)(3) organizations), and this chapter (other than this section) shall not apply to any foreign organization which has received substantially all of its support (other than gross investment income) from sources outside the United States."²⁰²

200. E.g., Rev. Proc. 93-23, § 6.12(2), Note, 1993-1 C.B. 538, 548.

201. It is understood that, in at least one case, the retroactive grant of § 501(c)(3) status went back more than 45 years.

202. For this purpose, "substantially all" means "at least 85 percent," "support" is defined in § 509(d), and gifts or contributions from non-U.S. persons are treated as from foreign sources. Treas. Reg. § 53.4948-1(b). It seems clear from the statute that foreign organizations which *do* receive more than 15% of their support from U.S. sources are not protected by § 4948(b).

Although § 4948(b) would appear to cover virtually all foreign charities, the Service has sometimes suggested that it applies only to foreign private foundations.²⁰³ Not only is that narrow reading inconsistent with the statutory language,²⁰⁴ but — even if it is accepted — the § 4948(b) exemption may apply, because the Code contains a presumption that any organization that fails to notify the Service, under § 508(a), is a private foundation.²⁰⁵ Thus, a silent foreign public charity would be presumed to be within § 4948(b) even if that section is narrowly read to apply only to foreign private foundations.

Although Service personnel sometimes assert that no foreign public charity can qualify under § 501(c)(3) if it fails to make a timely filing,²⁰⁶ in other instances the Ser

203. IRS CPE '92, supra note 34, at 235-36.

204. I.R.C. § 4948(a) refers to a "foreign organization which is a private foundation," whereas I.R.C. § 4948(b) refers only to a "foreign organization," without any qualifying language. On the other hand, I.R.C. § 4948(c), discussed below, makes § 4948(b) inapplicable to any "foreign organization" (without any qualifying language) which engages in a "prohibited transaction" under chapter 42, and the relevant prohibitions are generally applicable only to private foundations. The relevant Treasury Regulations follow this pattern, limiting the prohibited-transaction rules to foreign private foundations, but stating the general rule — that excepts certain entities from the I.R.C. § 508 notification requirement — as applicable to "any foreign organization." Compare Treas. Reg. §§ 53.4948-1(c)(1) and (2)(i) with Treas. Reg. § 53.4948-1(b).

205. I.R.C. § 508(b). See also Treas. Reg. § 1.508-1(b)(1).

206. For example:

"[A]ll foreign nonprivate foundation applicants (unless they fall within exceptions set forth in Reg. 1.508-1(a)(3)) and those rare foreign private foundation applicants that receive more than 15 percent of their support from United States sources must notify the Service that they are applying for recognition of exemption within 15 months from the end of the month on which they are or-
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vice recognizes that both foreign public charities and foreign private foundations may indeed so qualify without filing a notice.²⁰⁷ The latter view should prevail, not only for the reasons urged above, but because it is completely foolish to assume that any meaningful number of foreign charities will even be aware of, much less choose to comply with, any requirement to file with the U.S. Internal Revenue Service.

The Service and the Treasury should eliminate these inconsistent messages with a clear and appropriately-crafted exemption from filing for foreign charities.²⁰⁸ In early 1994, the Service took a limited step in a similar direction by exempting certain foreign charities from filing Forms 990 (the annual return required of most charities) so long as they normally receive not more than \$25,000 in gross receipts from U.S. sources and have "no significant activity" in the U.S.²⁰⁹

2. Income Tax Consequences. A foreign organization that qualifies under § 501(c)(3) is "exempt from taxation under this subtitle,"²¹⁰ which includes all of the income tax provisions and the chapter 3 withholding tax provisions. Thus, the Service

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ganized." IRS CPE '92, supra note 34, at 235-36.

207. That is the entire message of Rev. Proc. 92-94, 1992-2 C.B. 507. Furthermore, the regulations, in several places, allow domestic persons to make their own determinations that a foreign charity is described in I.R.C. § 501(c)(3) when it has not filed with the Service. E.g., Treas. Reg. §§ 1.1443-1(b)(4)(i), 1.1494-1(b)(1), 53.4942(a)-3(a)(6)(i), 53.4945-5(a)(5).

208. I.R.C. § 508(c)(2)(B) explicitly grants authority to do this.

209. Rev. Proc. 94-17, 1994-5 I.R.B. 24.

210. I.R.C. § 501(a).

confirmed, as early as 1922,²¹¹ that a foreign charity was not liable for tax on U.S.-source bond interest received by it, and no withholding of tax was required. The Service has restated that early precedent several times.²¹² Each of these rulings, however, requires the foreign charity to notify the withholding agent of its exempt status, and each "suggests" doing so in language that refers to the Service's *determination* of the foreign charity's exempt status.

Because a foreign charity may qualify under § 501(c)(3) without asking the Service for any such determination, it would seem that no tax (and no withholding) should be imposed on such "silent" foreign entities. No authority was found bearing on this question, however. In other analogous situations, the regulations provide for making good-faith determinations of the charitable status of the silent entity,²¹³ but no such regulations appear to cover this general case. Nevertheless, if the withholding agent is prepared to rely on its own analysis of the exempt status of a silent foreign charity, it should be protected if that judgment can be substantiated.²¹⁴

211. I.T. 1399, I C.B. 167 (1922).

212. I.T. 1399 was superseded by Rev. Rul. 70-570, 1970-2 C.B. 177, which in turn was superseded by Rev. Rul. 72-244, 1972-2 C.B. 282. The last ruling is supported by G.C.M. 34769 (Feb. 8, 1972).

213. E.g., Treas. Reg. §§ 1.1443-1(b)(4)(i), 1.1494-1(b)(1), 53.4942(a)-3(a)(6)(i), and 53.4945-5(a)(5).

214. Because there is no explicit requirement that the withholding agent receive any particular form or statement, this situation is unlike that in Casa de la Jolla Park, Inc. v. Commissioner, 94 T.C. 384 (1990), in which the government successfully held a withholding agent liable — despite the existence of a possibly-valid factual exemption from withholding — because of the agent's failure to obtain a form prescribed by the relevant withholding regulations. (The author's willingness thus to distinguish Casa de la Jolla should not be taken as any indication of his agreement with its holding.)

The unrelated business income of foreign charities²¹⁵ usually will not be subject to withholding at the source. Although the Code provides authority for withholding,²¹⁶ the regulations elaborate:

"In the case of a foreign tax-exempt organization which is subject to the tax imposed by section 511, any income received by such organization . . . which is includible under section 512 in determining its unrelated business taxable income, shall be subject to withholding under § 1.1441-1 unless such income is, or may be expected to be, effectively connected with the conduct of a trade or business within the United States."²¹⁷

Unrelated business income will usually be "effectively connected" with a U.S. business because (i) unrelated business income is typically generated from a regularly-carried-on business, (ii) the same standard is used to determine whether activities constitute a business under both I.R.C. § 512 and I.R.C. § 162,²¹⁸ (iii) that same standard is frequently used by courts to determine whether a foreign person is "engaged in trade or business within the United States,"²¹⁹ and (iv) if a U.S. trade or business is found, the resulting business income will almost always be characterized as "effectively connected" with it.²²⁰ An eligible foreign charity may claim exemption from withholding by

215. I.R.C. § 511(a), which imposes the tax, applies to charities per § 511(a)(2)(A). I.R.C. § 501(b) makes clear that an organization "shall be considered an organization exempt from income taxes" notwithstanding its liability for tax under § 511 et seq.

216. I.R.C. § 1443(a).

217. Treas. Reg. § 1.1443-1(a)(2).

218. See supra note 134.

219. See discussion and cases cited in 2 JOEL D. KUNTZ & ROBERT J. PERONI, U.S. INTERNATIONAL TAXATION ¶ C1.04[4][a] (1992) [hereinafter cited as KUNTZ & PERONI].

220. I.R.C. § 864(c). This somewhat over-simplified analysis is intended to spare the
(continued...)

filing Form 4224.²²¹ It will be required to prepare and file a return, and to pay the tax due, with respect to the unrelated business income.²²²

If the foreign charity is a partner in a U.S. partnership that, in turn, derives income which, as to the charity, is unrelated business income, a separate withholding regime under I.R.C. § 1446 may apply. The specific language of § 1443(a) suggests that withholding will be required of the partnership: it states that "this chapter" shall apply, and § 1446 is within chapter 3. Because § 1446 was not part of the Code when § 1443(a) was adopted, however, the regulations under the latter provide no useful guidance. The possibilities include: only § 1443 withholding will apply, only § 1446 withholding will apply, both will apply, or neither will apply. Because the last two are unrealistic, the real issue is between the first two. If only § 1443 withholding applies — perhaps because § 1443(a) is so specifically tailored to foreign charities that it would be deemed to be the provision Congress here intended to govern — the foreign charity could still avoid withholding by filing a Form 4224 in appropriate cases. Because that result is precisely what § 1446 generally aimed to change, it seems more

(...continued)

reader the grief of reading any of the more-lengthy analyses elsewhere available. See, e.g., Harvey P. Dale, Effectively Connected Income, 42 TAX L. REV. 689 (1987); KUNTZ & PERONI, supra note 219, at ¶ C1.04[5].

221. Treas. Reg. § 1.1443-1(a)(2) cross-refers to Treas. Reg. § 1.1441-4(a)(2), which requires a statement of the relevant circumstances and which says that the statement "may be made on a properly executed Form 4224"

222. A foreign tax credit can be claimed, in appropriate cases, for foreign taxes imposed on the same income. I.R.C. §§ 515, 901(b)(4), and 906. There is no explicit grant of a credit for foreign *trusts*, which may create a further problem for foreign charities using that form. But see I.R.C. § 641(b), and Treas. Reg. §§ 1.871-2(a) and 301.7701-5, all suggesting that — for at least certain purposes — a trust is to be treated as an individual.

likely that, when the § 1446 regulations are ultimately proposed, they will provide that they supersede § 1443 in these circumstances.²²³

If a foreign charity's unrelated business income is *not* "effectively connected" with a U.S. business,²²⁴ then withholding will be required under § 1443(a). Withholding will apply to all such income, regardless of whether it constitutes "fixed or determinable annual or periodical" income under the typical tests for chapter 3 withholding.²²⁵ Withholding may create difficult administrative and compliance issues in some cases, e.g., when the income constitutes gain from sale of property and the withholding agent lacks the information necessary to compute the foreign charity's cost of goods sold or basis.

Bilateral tax treaties sometimes contain provisions affecting the above discussion. In most of such treaties, however, the relevant provisions appear merely to confirm, but to add little or nothing to, the domestic U.S. rules.²²⁶

223. Accord, KUNTZ & PERONI, *supra* note 219, at ¶ C2.06.

224. This result can occur in one of two ways: either (1) the income might arise without any trade or business activity in the U.S. (as might occur, e.g., if the foreign charity generated unrelated debt financed income under I.R.C. § 514, or derived interest from a controlled subsidiary under I.R.C. § 512(b)(13)), or (2) the income might escape "effectively connected" status under I.R.C. § 864(c) despite the existence of a U.S. trade or business.

225. See generally Harvey P. Dale, Withholding Tax on Payments to Foreign Persons, 36 TAX L. REV. 49, 58-63 (1980).

226. Convention Between the United States of America and Canada with Respect to Taxes on Income and Capital, Sept. 26, 1980, U.S.-Can., art. XXI(1), (3), and (4), T.I.A.S. No. 11,087; Convention Between the Government of the United States of America and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Sept. 18, 1992, U.S.-Mex., art. 22(1) and (4), T.I.A.S. No. 11,727; Convention Between the
(continued...)

B. Foreign Private Foundations.

1. Tax-Exempt Status. Because private foundations are a subset of § 501(c)(3) entities,²²⁷ the rules generally covering foreign charities also apply to foreign private foundations. Although even the Service agrees that I.R.C. § 4948(b) exempts foreign private foundations from filing under I.R.C. § 508,²²⁸ a foreign private foundation that either fails to meet the "substantially all" test of § 4948(b) or engages in a prohibited transaction,²²⁹ two consequences flow: *first*, the § 508(a) notice requirements will apply; *second*, exempt status will be lost completely unless the foreign organization has certain provisions in its governing instrument covering mandatory distributions of income, self-dealing, excess business holdings, jeopardizing investments, and taxable transactions.²³⁰

2. Income and Excise Tax Consequences. A foreign private foundation is not subject to the 2% excise tax of I.R.C. § 4940; in lieu of that tax, it is subject to a 4%

226. (...continued)
United States of America and the Union of Soviet Socialist Republics on Matters of Taxation, June 20, 1973, U.S.-U.S.S.R., art. IX, 27 U.S.T. 1; Income Tax Treaty Between Germany and the United States, Aug. 29, 1989, U.S.-Ger., art 27, S. Treaty Doc. No. 10, 101st Cong., 2d Sess. (1990).

227. I.R.C. § 509(a).

228. IRS CPE '92, supra note 34, at 235.

229. I.R.C. § 4948(c).

230. I.R.C. § 508(e)(1). See Treas. Reg. § 1.508-3. Although the regulations provide an exception if the necessary provisions are contained in "valid . . . State law," Treas. Reg. § 1.508-3(d)(1), "[n]o foreign government . . . appears to have enacted [such] a provision" IRS CPE '92, supra note 34, at 236. Query: if a foreign government *did* enact such a provision, would that constitute a "State law" within the meaning of the regulations?

tax on its "gross investment income . . . derived from sources within the United States."²³¹ The tax is collected by withholding at the source.²³² A foreign private foundation which is *not* exempt, e.g., because it lacks required provisions in its governing instrument, is then subject to tax as a nonresident alien; it is not subject to the § 4940 excise tax.²³³

With the exception of these particular rules, a foreign private foundation is subject to the same taxing regime that applies to foreign public charities.

IV. Some Non-tax Aspects of Gifts to Foreign Charities

The following discussion is quite cursory. It is intended more to alert potential donors and their advisers to the issues than to analyze them or to set forth methods of avoiding or complying with the rules.

A. Export Administration Act. The Export Administration Act, as amended,²³⁴ authorizes restrictions to be imposed on the export of "goods" and "technology."²³⁵ It does not generally permit restrictions on the export of money.²³⁶ Most donations to foreign charities will thus be unaffected by the EAA.

If donations are made in kind, rather than in cash, however, the EAA may apply. Regulations under the EAA, administered by the Department of Commerce, are adopt-

231. I.R.C. § 4948(a).

232. I.R.C. § 1443(b).

233. G.C.M. 38840 (Apr. 22, 1982).

234. 50 U.S.C. app. §§ 2401-20 (1991 and Supp. 1993) [hereinafter cited as EAA].

235. 50 U.S.C. app. §§ 2404(a)(1) (1991).

236. Except to the extent the money is export financing. 50 U.S.C. app. § 2414(b) (1991).

ed to deal with national security, foreign policy, and economic considerations.²³⁷ The Act does *not* permit restrictions to be placed on exports in the following situations:

1. Exports of medicine or medical supplies for foreign policy reasons unless the President determines such controls to be necessary and Congress enacts a law authorizing such controls.²³⁸
2. Exports of goods "intended to meet basic human needs" for foreign policy reasons.²³⁹
3. Exports of medical instruments and equipment for national security reasons.²⁴⁰

Otherwise, the EAA authorizes restrictions on export of goods, and the regulations do restrict exports in various ways. Although in general the regulations contain few references to donated goods, they do embargo the export of donated goods to Libya, North Korea, and Cuba.²⁴¹ Even in those cases, they establish the "Humanitarian License Procedure,"²⁴² which authorizes two-year licenses enabling donations of

237. 50 U.S.C. app. § 2402(2) (1991).

238. 50 U.S.C. app. §§ 2405(g) and (r) (1991 and Supp. 1993).

239. 50 U.S.C. app. § 2405(g) (1991). "Basic human needs" involve "those requirements essential to individual wellbeing: health, food, clothing, shelter, and education." 15 C.F.R. § 773.5(a) (1992).

240. 50 U.S.C. app. §§ 2404(c)(5)(A)(ii) and (m) (1991).

241. 51 Fed. Reg. 8,482 (Mar. 12, 1986). The listed countries in 1986 included Cambodia and Vietnam, both of which have since been eliminated from the restricted list. 57 Fed. Reg. 11,576-02 (Apr. 6, 1992); 59 Fed. Reg. 6,524-01 (Feb. 10, 1994).

242. 15 C.F.R. § 773.5 (1992).

articles intended to meet basic human needs, so long as the delivery is monitored to "alert the donor if goods are being diverted."²⁴³

B. Trading with the Enemy Act and International Emergency Economic Powers Act. The Trading with the Enemy Act²⁴⁴ has now largely, but not entirely, been replaced by the International Emergency Economic Powers Act.²⁴⁵ Both apply only after there has been a declaration of national emergency by the President, or during a time of war. The TWEA permits regulation or prohibition of donations of both money and goods, but it now only applies to a very few countries: North Korea, Cambodia, and Cuba.²⁴⁶ The IEEPA permits regulation or prohibition of donations of money, but does not permit regulation or prohibition of donations of goods unless certain specific determinations of risk of harm to the U.S. have been made (and none appear to have been made). Thus, under the IEEPA, donations of money may be regulated in the following cases (in which emergencies have been held to exist): Angola,²⁴⁷ Haiti,²⁴⁸ the

243. 15 C.F.R. § 773.5(e) (1992). There is an argument that these regulations are invalid, and that compliance with the Humanitarian License Procedure is unnecessary. It is based on Veterans Peace Convoy, Inc. v. Schultz, 722 F. Supp. 1425 (S.D. Tex. 1988), refusing to apply the Humanitarian Aid exemption rules when the President had failed to make a special finding of a national emergency.

244. 50 U.S.C. app. §§ 1-44 (1990 & Supp. 1993) [hereinafter cited as TWEA].

245. 50 U.S.C. §§ 1701-06 (West 1991 & Supp. 1993) [hereinafter cited as IEEPA].

246. President Clinton recently extended the coverage of the TWEA to these countries, through Sept. 14, 1994, by Presidential Determination No. 93-38, 3 C.F.R. 772 (1993). The order extend the TWEA regulations to more than the three named countries, but it is only in the case of those three countries that charitable donations are regulated.

247. Exec. Order No. 12,865, 3 C.F.R. 636 (1993), reprinted in 50 U.S.C. § 1701 (1994).

(continued...)

Federal Republic of Yugoslavia (Serbia and Montenegro),²⁴⁹ Iran,²⁵⁰ Libya,²⁵¹ and Iraq.²⁵²

C. Other. The United States' relationship with the United Nations is based on the U.N. Participation Act of 1945.²⁵³ It authorizes the U.S. to regulate or prohibit certain transactions pursuant to a United Nations Security Council mandate. The language of the statute is quite sweeping, and much broader than any of the EAA, TWEA,

(...continued)

248. Exec. Order No. 12,775, 3 C.F.R. 349 (1992), reprinted in 50 U.S.C. § 1701 (1988 and Supp. 1993). Additional orders were given, blocking certain properties, in Exec. Order No. 12,853, 3 C.F.R. 612 (1993), reprinted in 50 U.S.C. § 1701 (1988 and Supp. 1993) and Exec. Order No. 12,872, 3 C.F.R. 658 (1993), reprinted in 50 U.S.C. § 1701 (1988 and Supp. 1993). The emergency was most recently extended by notice on September 30, 1993, 3 C.F.R. 377 (1993).

249. The emergency declared in Exec. Order No. 12,808, 3 C.F.R. 305 (1992), reprinted in 50 U.S.C. § 1701 (1988 and Supp. 1993), was expanded in Exec. Order No. 12,810, 3 C.F.R. 307 (1992), reprinted in 50 U.S.C. § 1701 (1988 and Supp. 1993), Exec. Order No. 12,831, 3 C.F.R. 576 (1993), reprinted in 50 U.S.C. § 1701 (1988 and Supp. 1993), and Exec. Order No. 12,846, 3 C.F.R. 599 (1993), reprinted in 50 U.S.C. § 1701 (1988 and Supp. 1993). The emergency was most recently extended by notice of May 26, 1993, 3 C.F.R. 75 (1993).

250. The emergency declared in Exec. Order No. 12,170, 44 Fed. Reg. 65,729 (1979), reprinted in 50 U.S.C. § 1701 (1988), was most recently extended by Notice of Nov. 1, 1993, 3 C.F.R. 796 (1993).

251. The emergency declared in Exec. Order No. 12,543, 3 C.F.R. 181 (1980), reprinted in 50 U.S.C. § 1701 (1988), was most recently extended by Notice of Dec. 2, 1993, 3 C.F.R. 796 (1993).

252. The emergency declared in Exec. Order No. 12,722, 3 C.F.R. 294 (1993), reprinted in 50 U.S.C. § 1701 (1988 and Supp. 1993), was most recently extended by Notice of July 21, 1993, 3 C.F.R. 762 (1993).

253. 22 U.S.C. § 287 (1990) [hereinafter cited as UNPA].

or IEEPA provisions. It appears that only Iraq and Yugoslavia are currently covered by UNPA-relevant Security Council mandates.²⁵⁴ The regulations impose restrictions on sending humanitarian aid to those countries in language that is more restrictive than would be authorized under the IEEPA.

V. Conclusion

It is impossible to justify the incredible complexity, inconsistency, and impenetrability of the relevant statutory, regulatory, and other authorities bearing on foreign charities. There can be no reason — and there is *certainly* no rhyme — to the current pattern. At a bare minimum, the following steps should be taken:

1. Congress should repeal § 170(c)(2)(A).
2. Congress should repeal the flush language at end of § 170(c)(2) requiring U.S. corporate donors, interested in having their gifts used outside of the United States, to give only to domestic corporate entities.
3. The Service should extend Rev. Proc. 92-94 to public charities and to situations other than those arising under chapter 42.
4. Congress should revisit and clean up §§ 2055 and 2522.
5. Congress, the Treasury, or the Service should provide guidance that § 679 does not apply to charitable gifts.
6. The Treasury should eliminate the compliance requirement, under § 1494, for transfers to foreign charities.²⁵⁵
7. The Service should make clear that foreign charities may qualify under § 501(c)(3) without regard to whether they have filed notices under § 508.

254. 31 C.F.R. §§ 575.5210, 575.521 (1993) (Iraq); 31 C.F.R. §§ 585.521, 585.522, and 585.524 (1993) (Yugoslavia).

255. See Treas. Reg. § 1.1494-1(b).

8. The regulations to be issued under § 1446 should clarify how withholding under that section will be coordinated with tax and withholding under § 1443.
9. The Treasury should make clear, in regulations to be issued dealing with generation skipping transfers, that gifts to charities will not trigger the tax.
10. Congress, the Department of Commerce, and the Treasury should rethink and perhaps repeal the non-tax barriers to international charitable giving.

Appendix A

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Appendix B

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

SECTION 1. PURPOSE

Private foundations generally want their grants to foreign grantees to be treated as qualifying distributions for purposes of section 4942 of the Internal Revenue Code rather than as taxable expenditures for purposes of section 4945 of the Code. This treatment is assured if the foreign grantee has a ruling or determination letter classifying it as a public charity within the meaning of section 509(a)(1), (2), or (3), or a private operating foundation under section 4942(j)(3) of the Code. If a foreign grantee does not have such a ruling or determination letter, the Foundation Excise Tax Regulations set forth requirements that must be satisfied in order to assure that the grant will be considered a qualifying distribution.

In response to requests from private foundations, this revenue procedure provides a simplified procedure that private foundations (including nonexempt charitable trusts) may follow in making "reasonable judgments" and "good faith determinations" under sections 53.4945-6(c)(2)(ii), 53.4942(a)-3(a)(6) and 53.4945-5(a)(5) of the Foundation Excise Tax Regulations. If the requirements of this revenue procedure are met, a grant to a foreign grantee will be treated as a grant to an organization that is described in section 501(c)(3) or section 4947(a)(1) of the Internal Revenue Code, and, that is either a public charity within the meaning of section 509(a)(1), (2), or (3), or a private operating foundation under section 4942(j)(3) of the Code.

SEC. 2. BACKGROUND

01 Section 53.4945-6(c)(2)(ii) of the regulations applies to a private foundation (grantor) making a grant for certain purposes to a foreign organization (grantee) that does not have a ruling or determination letter recognizing it as an organization described in section 501(c)(3) of the Code. ("Certain purposes" are those described in section 170(c)(2)(B) except for any transfer of assets pursuant to any liquidation, mer-

ger, redemption, recapitalization, or other adjustment, organization, or reorganization described in section 507(b)(2).) The grantor may treat such a grant as a grant to an organization described in section 501(c)(3) (other than section 509(a)(4)) if, in the reasonable judgment of the foundation manager, the grantee is an organization described in section 501(c)(3) (other than section 509(a)(4)).

02 Sections 53.4942(a)-3(a)(6) and 53.4945-5(a)(5) of the regulations apply to a distribution (or grant) for the purposes described in section 170(c)(2)(B) of the Code to a foreign organization that has not received a ruling or determination letter that it is a public charity described in section 509(a)(1), (2), or (3), or an operating foundation described in section 4942(j)(3). In this case, the grant will be treated as a grant to a public charity (for purposes of both sections 4942 and 4945) or to an operating foundation (for purposes of section 4942 only) if the grantor has made a "good faith determination" that the grantee is described in section 509(a)(1), (2), or (3), or section 4942(j)(3).

03 Under sections 53.4942(a)-3(a)(6) and 53.4945-5(a)(5) of the regulations, a "good faith determination" may be based on an affidavit of the grantee or an opinion of counsel of either the grantor or the grantee. The affidavit or opinion of counsel must give enough facts about the grantee's operations and support to enable the Internal Revenue Service to determine that the grantee would likely qualify as an organization described in section 509(a)(1), (2), or (3), or section 4942(j)(3) of the Code.

04 Thus, under the regulations, a foundation that wishes to have a grant treated as a grant to a public charity must complete two steps. First, the foundation manager of the grantor must make a "reasonable judgment" that the grantee is an organization described in section 501(c)(3) (other than section 509(a)(4)). Second, the grantor must make a good faith determination, based on an affidavit of the grantee or an opinion of counsel of either the grantor or the grantee, that the grantee is described in section 509(a)(1), (2), or (3), or section 4942(j)(3).

SEC. 3. SCOPE

This revenue procedure applies to a grant made for purposes set out in section 170(c)(2)(B) of the Code, (except for any transfer of assets pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization described in section 507(b)(2)), if the grant is made by a domestic private foundation to a foreign organization that does not have an Internal Revenue Service ruling letter recognizing its exemption under section 501(c)(3), or classifying it as a public charity under section 509(a)(1), (2), or (3), or as a private operating foundation under section 4942(j)(3).

SEC. 4. PROCEDURE

.01 A private foundation will be deemed to have satisfied the requirements of sections 53.4945-6(c)(2)(ii), 53.4942(a)-3(a)(6), and 53.4945-5(a)(5) of the regulations if (1) a grant is not a transfer of assets pursuant to any liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization described in section 507(b)(2) of the Code, and (2) the grantor bases its "reasonable judgment" and "good faith determination" (as described in the regulations) on a "currently qualified" affidavit prepared by the grantee for the grantor or another grantor that contains the information set out in Sec. 5., below. The original affidavit, or a photocopy of the original affidavit, must be retained by the grantor and made available to the Service upon request. Whether an affidavit is "currently qualified" is discussed in .02 through .06, below. If, however, the grantor possesses information that suggests the affidavit may not be reliable, it must consider that information in determining whether the affidavit is currently qualified.

.02 An affidavit will be considered currently qualified as long as the facts it contains are up to date, as provided in either .03 or .04, below, and as long as the relevant substantive requirements of sections 501(c)(3) and 4947(a)(1) of the Code and sections 509(a)(1), (2), or (3) or section 4942(l)(3) remain unchanged.

03 The facts in an affidavit will be considered up to date if those facts reflect the grantee organization's latest complete accounting year or the affidavit is updated to reflect the grantee organization's current data as described in .04 below.

04 Where a grantee's status under sections 501(c)(3) and 4947(a)(1), 509(a)(1), (2), or (3) or section 4942(j)(3) of the Code does not depend on financial support, which can change from year to year, an affidavit need be updated only by asking the grantee to amend the description of any facts in the original affidavit that have changed. If the facts have not changed, an attested statement by the grantee to that effect is enough to update an affidavit.

Where a grantee's status under section 509(a)(1) (2), or (3) or section 4942(j)(3) depends on financial support, the affidavit must be updated by asking the grantee to provide an attested statement containing enough financial data to establish that it continues to meet the requirements of the applicable Code section.

05 The information required by .04, above, is not necessarily financial data from the grantee's latest accounting year. For example, financial data from years 1985, 1986, 1987, and 1988 are enough to establish that an organization is "publicly supported" within the meaning of section 509(a)(2) of the Code for years 1989 and 1990 if the granting foundation is not responsible for a substantial and material change in the grantee organization's sources of support in years 1989 and 1990. See section 1.509(a)-3(c)(1) of the regulations. A grantor will not be considered responsible for a substantial and material change in the grantee's sources of financial support as long as:

(1) The grantee's affidavit is "currently qualified" within the meaning of .04, above;

(2) The grantor neither has learned that the Internal Revenue Service is challenging the validity of the grantee's affidavit, nor has reason to doubt that the affidavit remains valid; and

(3) The grantee is not controlled directly or indirectly by the grantor. A grantee is controlled by the grantor if the grantor and disqualified persons (defined in section 4946(a)(1)(A) through (G) of the Code) with respect to the grantor, by aggregating their votes or positions of authority, may require the grantee to perform any act that significantly affects its operations or may prevent the grantee from performing such an act.

06 Private foundations are permitted but not required to use the procedures described above in making grants to foreign organizations. The two-step procedure referred to in Section 2.04, above, is still the general mechanism for meeting the requirements of sections 53.4945-(c)(2)(ii), 53.4942(a)-3(a)(6) and 53.4945-5(a)(5) of the regulations.

SEC. 5. AFFIDAVIT REQUIREMENTS

01 An affidavit must be written in English and contain the substantive information set out below. However, the affidavit need not strictly follow the form set forth below. An English translation must be provided for any supporting documents that are not written in English. The affidavit must be attested to by a principal officer of the grantee organization.

02 Affidavits for grantee organizations described in section 170(b)(1)(A)(vi) of the Code must include a financial schedule as described in .04(11), below. Grantee organizations described in section 509(a)(2) must provide comparable information.

03 Any grantee that claims to be a school described in section 170(b)(1)(A)(ii) of the Code must provide the statement set out in .04(12), concerning whether it operates pursuant to a racially nondiscriminatory policy as to students. Section 170(b)(1)(A)(ii) describes "an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried

on." In addition, the affidavit must explain any basis for the grantee school's failure to comply with one or more of the provisions of Rev. Proc. 75-50, 1975-2 C.B. 587.

04 The affidavit must contain a declaration to the following effect: "The undersigned, to assist grantmaking foundations in the United States of America determine whether [name of grantee organization] (the grantee organization) is the equivalent of a public charity described in section 509(a)(1), (2) or (3) of the United States Internal Revenue Code or a private operating foundation described in section 4942(j)(3) of the Code, makes the following statement:

"(1) I am the [title of principal officer] of the grantee organization.

"(2) The grantee organization was created by [identify statute, charter, or other document] in [year], and is operated exclusively for [check applicable box or boxes]:

charitable

religious

scientific

literary

educational

fostering national or international amateur sports competition, or

prevention of cruelty to children or animals

purposes under the laws of [the country in which the grantee organization was formed].

"(3) The activities of the grantee organization have included [describe past and current activities and operations] and will include [describe future activities and operations].

"(4) Copies of the charter, bylaws, and other documents pursuant to which the grantee organization is governed are attached.

"(5) The laws and customs applicable to the grantee organization do not permit any of its income or assets to be distributed to, or applied for the benefit of, a private

person or non-charitable organization other than pursuant to the conduct of the grantee organization's charitable activities, or as payment of reasonable compensation for services rendered or as payment representing the fair market value of property which the grantee organization has purchased.

"(6) The grantee organization has no shareholders or members who have a proprietary interest in the income or assets of the organization.

"(7) In the event that the grantee organization were to be liquidated or dissolved, under the laws and customs applicable, or under the governing instruments, all its assets would be distributed to another not-for-profit organization for charitable, religious, scientific, literary, or educational purposes, or to a government instrumentality. A copy of the relevant statutory law or provisions in the governing instruments controlling the distribution of the organization's assets on liquidation is attached.

"(8) The laws and customs applicable to the grantee organization do not permit the organization, other than as an insubstantial part of its activities,

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

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

"(9) The laws and customs applicable to the grantee organization do not permit the organization directly or indirectly to participate or intervene in any political campaign on behalf of, or in opposition to, any candidate for public office.

"(10) The grantee organization is not controlled by or operated in connection with any organization other than as follows [describe]:

"(11) (The following is required only if the grantee organization's status under sections 501(c)(3) and 4947(a)(1), 509(a)(1), (2), or (3) or section 4942(j)(3) of the Code depends on its financial support.) A schedule of support for the four most recently completed taxable years is attached showing (for each year and in total)

(A) Gifts, grants, and contributions received;

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- (B) Membership fees received;
 - (C) Gross receipts from admissions, merchandise sold or services performed, or furnishing of facilities in any activity that is not a business unrelated to the organization's exempt purposes;
 - (D) Gross income from interest, dividends, rents, and royalties;
 - (E) Net income from business activities that are unrelated to the organization's exempt purposes;
 - (F) The value of services or facilities furnished by a governmental unit without charge;
 - (G) The total of lines (A) through (F);
 - (H) Line (G) minus line (C);
 - (I) Two percent of line (H);
 - (J) A schedule of contributions for each donor whose support for the four-year period was greater than the amount on line (I) (a major donor), and showing the amount by which each major donor's total contributions exceeded the amount on line (I) (excess contributions);
 - (K) The sum of all major donors' excess contributions;
 - (L) The four-year total for line (H) minus the four-year totals of lines (D), (E), and (K) (the amount of public support);
 - (M) Line (L) divided by the four-year total for line (H) (the percentage of the organization's support that is public support).

"(12) (The following is required only if the grantee is not a public charity described in section 509(a)(1), (2), or (3) of the Code but claims to be an operating foundation described in section 4942(j)(3) of the Code.) A schedule showing that the organization satisfies (i) the income test of section 53.4942(b)-1(a) of the regulations and (ii) one of the alternative tests described in section 53.4942(b)-2.

"(13) (The following is required only if the grantee is a school described in section 170 of the Code.) The grantee organization is an organization described in section 170(b)(1)(A)(ii) of the Code that has adopted and operates pursuant to a racially nondiscriminatory policy as to students, as set forth in Rev. Rul. 71-447, 1971-2 C.B. 230, and Rev. Rul. 75-231, 1975-1 C.B. 158, and as implemented in Rev. Proc. 75-50, 1975-2 C.B. 587."