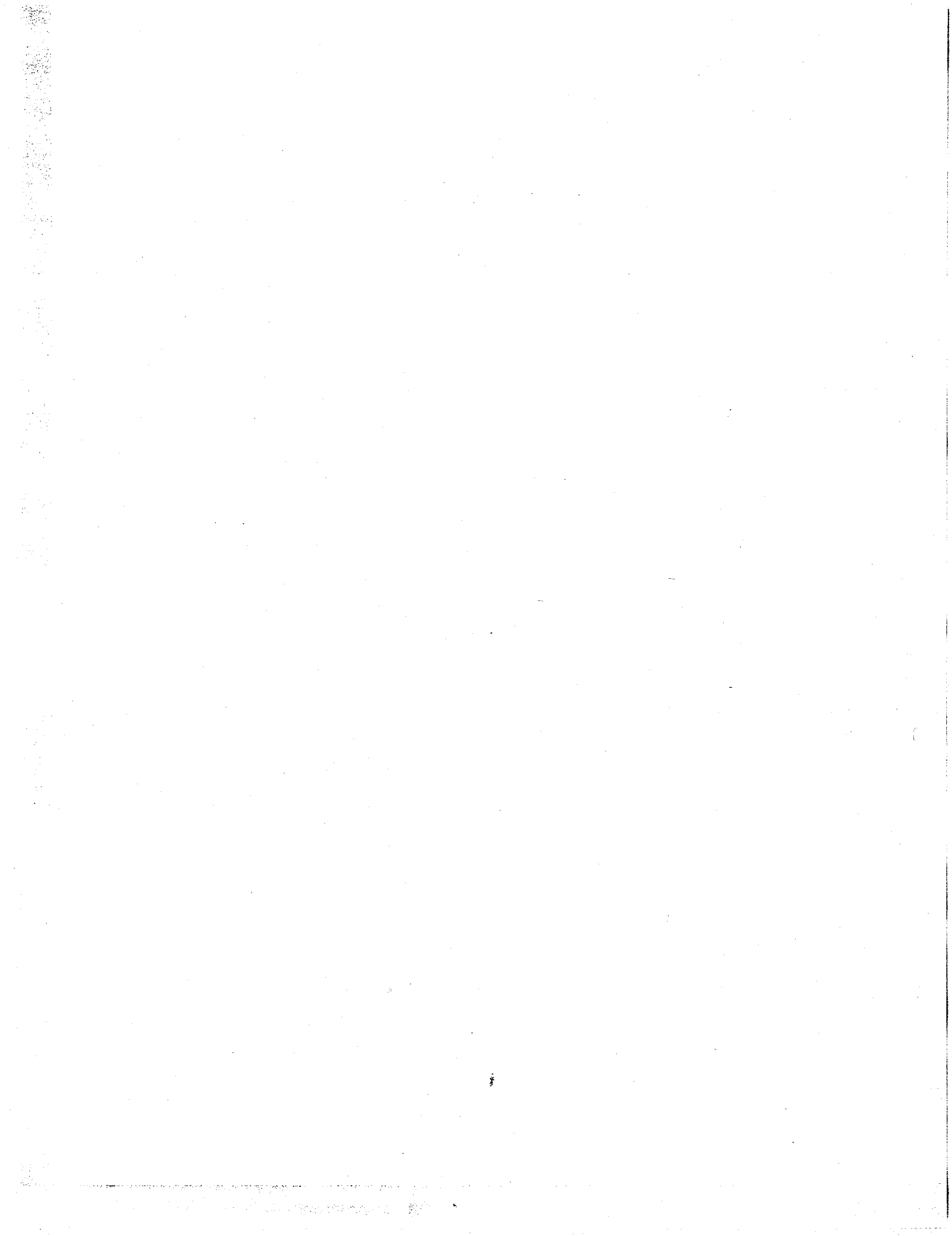


Cross-border Charitable Giving*

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I) Introduction¹

This article will discuss both tax and non-tax restrictions governing international charitable giving. It will examine the policy rationales behind these constraints and discern whether the current structures are achieving their stated goals.

Charities are an important source of humanitarian relief and development aid in an increasingly international community. Surprisingly, there is still very little quantitative information available about the size and importance of international giving.² Giving by U.S. foundations for international purposes has nearly doubled since 1984.³ Contributions for international affairs were \$1.71 billion in 1992.⁴ However, contributions with international implications were even higher.⁵ Despite the importance of charitable giving for international purposes, significant limitations are imposed by the U.S. tax system. Restrictions are also imposed with respect to specific countries based

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² In 1985, the World Fundraising Council was founded to improve the effectiveness of worldwide fundraising. The Johns Hopkins Comparative Nonprofit Sector Project compiles data on international philanthropy.

³ THE FOUNDATIONS CENTER, THE FOUNDATION GRANTS INDEX 1994, at ix (1993).

⁴ AAFRC TRUST FOR PHILANTHROPY, GIVING USA: THE ANNUAL REPORT ON PHILANTHROPY FOR THE YEAR 1992, at 10 (1993) ["AAFRC REPORT"].

⁵ For example, contributions to the World Resource Institute and the Natural Resources Defense Council are classified under Environment/Wildlife. *Id.* at 102. Similarly, contributions to Arts International are classified under Arts, Culture and Humanities. *Id.* at 99.

upon foreign policy concerns. However, some recent tax treaties are attempting to liberalize rules in these areas.

This Article begins, in Part II, with a discussion of the income tax deduction for charitable contributions by individuals, followed by a discussion of the deduction for gift and estate tax purposes in Part III. The Article continues, in Part IV, with an examination of the income tax deduction for contributions by corporations. Part V discusses the rules governing charitable giving by exempt organizations, including public charities and private foundations. Part VI is a survey of various tax treaties which provide for mutual recognition of domestic charities and examines the effect that these treaties have on the U.S. tax deduction. Part VII provides a brief look into non-tax restrictions on charitable giving, including the Export Administration Act, the Trading With the Enemy Act, the International Emergency Economic Powers Act, and the U.N. Participation Act. The Article concludes by examining the inconsistencies inherent in the tax provisions and determines that the provisions are driven by form as opposed to substance. It offers a proposal to eliminate the place-of-use and place-of-incorporation restrictions and to establish instead a system which would more rationally ensure that the donee performs a charitable purpose, thus achieving the substantive policy goals behind the allowance of the charitable deduction.

II) Individual Giving

Congress has provided that individuals may receive an income tax deduction for charitable donations.⁶ Before examining how the deduction affects charitable contributions made specifically to foreign organizations, it is necessary to understand the basic law and regulations which control the charitable deduction.

A donation for purposes of section 170(c) is a gift made "to or for the use of some entity defined as charitable by section 170(c)(2), in

⁶ I.R.C. § 170(c)(2). All references herein are to the Internal Revenue Code of 1986, as amended ["I.R.C." or the "Code"]

exchange for which the donor receives nothing of value in return."⁷ This quid pro quo prohibition is similar to the definition which developed out of case law attempting to distinguish deductible business expenditures from gifts, except that it focuses on the donee's status as an exempt organization as well. The definition requires that a gift be made for the dominant reason of a "detached and disinterested generosity."⁸

Code section 170(c)(2) lists seven categories of organizations that may meet the definition of "charitable."⁹ The categories are: religious, charitable, scientific, literary, educational, fostering national or international amateur sports competition, and the prevention of cruelty to children or animals. Organizations within these categories must be

⁷ See BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL INCOME TAXATION OF INCOME, ESTATES & GIFTS, ¶ 35.13, at 35-38 (1990).

⁸ Commissioner v. Duberstein, 363 U.S. 278 (1960). See also Oppewal v. Commissioner, 468 F.2d 1000 (1st Cir. 1972) and De Jong v. Commissioner, 309 F.2d 373 (9th Cir. 1962), applying Duberstein test to charitable deductions. But see Crosby Valve & Gauge Co. v. Commissioner, 380 F.2d 146 (1st Cir. 1967), where the *Duberstein* test was *not* followed. See generally James W. Colliton, *The Meaning of "Contribution or Gift" for Charitable Contribution Deduction Purposes*, 41 OHIO ST. L.J. 974 (1980); *Quid Pro Quo*, 4 THE NATIONAL CENTER ON PHILANTHROPY AND THE LAW (forthcoming 1996).

⁹ The Code contains two separate tests for determining what constitutes a "charitable" organization. One is contained in § 170(c) and is used to determine whether a charitable organization is eligible to receive deductible contributions. The other is found in § 501(c)(3) and is used to determine whether an organization qualifies for tax-exempt status. Section 170 simply requires that the organization be "organized and operated for" one of the seven categories described in that section; it does not define the categories or explain the meaning of the phrase "organized and operated for." Section 501(c)(3) includes testing for public safety among its qualifying charitable purposes, unlike § 170(c). See Rev. Rul. 65-61, 1965-1 C.B. 234 (holding that an organization which tested pleasure boats for public safety does not qualify to receive deductible contributions under § 170(c)(2)).

The regulations enforcing § 170(c)(2) do not provide definitions for any of the purposes listed therein. However, the regulations enforcing § 501(c)(3) define "charitable" as having a purpose which "serves the public interest." Treas. Reg. § 1501(c)(3)-1(d)(2). Such a purpose includes relief of the poor, advancement of religion, education or science, erection of public buildings, lessening government burdens, lessening neighborhood tensions and other purposes listed in Treas. Reg. § 1501(c)(3)-1(d)(2). The Regulations also provide specific tests to determine whether an organization is "organized and operated for" an exempt purpose. Treas. Reg. § 1501(c)(3)-1(a) and (b). Although § 501(c)(3)'s tests are sometimes used to interpret § 170(c)(2), the two sections contain different standards. See *infra* note 11. This Article focuses only on the § 170(c) donee.

"organized and operated exclusively" for a charitable purpose defined in section 170.¹⁰

The Code thus provides deductions not only for contributions to organizations we consider "charitable" in an everyday sense, such as soup kitchens, but also for contributions to organizations such as museums and public radio stations. Case law emphasizes this breadth but invokes trust law's doctrine excluding organizations which counter public policy.¹¹

The Code uses percentage limitations¹² to limit the amount that individuals can deduct for charitable gifts in comparison to their

¹⁰ I.R.C. § 170(c)(2)(B). Section 170(c) narrows the acceptable charitable purposes listed in § 501(c)(3). In addition, in order to receive deductible contributions, organizations must meet § 501(c)(3)'s "organized and operated" tests to qualify for exempt status. However, the "organizational test," as defined in § 501(c)(3), requires that the recipient be "organized . . . exclusively" for one of the seven tax-exempt, charitable purposes that section lists. This requirement is met if the organization's articles of organization (e.g., its corporate charter, trust instrument, or articles of association) limit its purpose to one or more exempt purposes. In addition, the articles of organization may not expressly empower the organization to engage in activities that in themselves are not for one or more exempt purposes, unless such activities form an insubstantial part of the organization's primary function. The organization's organizing documents also must provide that upon dissolution, the organization's assets will be distributed for one or more exempt purposes.

The "operational test," as defined in § 501(c)(3), requires that the organization be "operated . . . exclusively" for one or more tax-exempt, charitable purposes in order to qualify for exemption. It can fulfill this requirement only if it engages primarily in activities that accomplish one or more of its exempt purposes. Thus, the organization's resources must be "devoted to purposes that qualify as exclusively charitable within the meaning of § 501(c)(3) of the Code and the applicable regulations."

In addition to passing these two tests, exempt organizations also must abide by restrictions against participating in activities that would constitute inurement, propaganda, or attempts to influence legislation or to participate or intervene in any candidate's political campaign. Treas. Reg. § 1.501(c)(3)-1(c)(2)(3).

¹¹ See *Bob Jones Univ. v. United States*, 461 U.S. 574 (1983) (prohibiting charitable deductions for donations to educational institutions that discriminate on the basis of race); *Green v. Connally*, 330 F. Supp. 1150 (D.D.C. 1971), *aff'd sub nom. Coit v. Green*, 404 U.S. 997 (1971); *United States v. Proprietors of Social Law Library*, 192 F.2d 481 (1st Cir. 1939).

¹² For a general description, see JAMES W. COLLITON, *CHARITABLE GIFTS* § 3 (1989). Colliton notes that the percentage limitation rules are "exceedingly complex and annoying. However, they do not generally cause major problems because few people make gifts large enough to trigger them." *Id.* at § 3.01.

contribution base.¹³ Historically, percentage limitations have increased: from 1918 to 1938, individuals were allowed to deduct an amount up to 15% of their contribution base;¹⁴ in 1952 this rose to 20%.¹⁵ Today, the general rule is stated in Code section 170(b)(1)(A). This section limits an individual's deductions for contributions to organizations listed in Code section 170(b)(1)(A) to not more than 50% of the contribution base.¹⁶

Section 170(b)(1)(B) allows deductions for any 170(c) contributions to *non-170(b)(1)(A)* organizations as long as they do not exceed: (1) 30% of the contribution base, or (2) the excess of 50% of the contribution base over the amount allowed under section 170(b)(1)(A).¹⁷ These organizations include non-public charities such as veterans' organizations,¹⁸ for-profit cemeteries,¹⁹ and domestic fraternal societies.²⁰

¹³ The contribution base is defined as the taxpayer's adjusted gross income, computed without regard to any net operating loss carryback to the taxable year under § 172. I.R.C. § 170(b)(1)(F).

¹⁴ Revenue Act of 1918, Pub. L. No. 65-254, § 214 (a)(11) 40 Stat. 1057, 1066 (1918); Revenue Act of 1921, Pub. L. No. 67-98, § 214 (a)(11), 42 Stat. 227, 241 (1921); Revenue Act of 1924, Pub. L. No. 68-176, § 214 (a)(10), 43 Stat. 253; Revenue Act of 1926, Pub. L. No. 69-20, § 214 (a)(10), 44 Stat. 9, 27 (1926); Revenue Act of 1928, Pub. L. No. 70-562, § 213 (c), 45 Stat. 791, 848 (1928); Revenue Act of 1932, Pub. L. No. 72-154, § 23 (n), 47 Stat. 173, 181 (1932); Revenue Act of 1934, Pub. L. No. 73-216, § 23 (o), 48 Stat. 680, 690 (1934); Revenue Act of 1935, Pub. L. No. 74-407, § 162 (c), 49 Stat. 1014, 1016 (1935); Revenue Act of 1936, Pub. L. No. 74-740, § 23 (o), 49 Stat. 1648, 1660 (1936); Revenue Act of 1937, Pub. L. No. 75-377, § 356 (a)(2), 50 Stat. 813, 816 (1937); Revenue Act of 1938, Pub. L. No. 75-554, § 23 (o), 52 Stat. 447, 463 (1938).

¹⁵ Revenue Act of 1952, Pub. L. No. 82-17, § 23(o). The Senate Finance Committee reported that by raising the limit from 15% to 20%, "much needed relief will be given to colleges, hospitals, and other organizations who are becoming more and more dependent upon private contributors to enable them to balance their budgets and carry on their programs." S. REP. NO. 1584, 82d Cong., 2d Sess., reprinted in J.S. SEIDMAN, SEIDMAN'S LEGISLATIVE HISTORY OF FEDERAL INCOME TAX LAWS 1953-1939, AT 1364 (1953) ["SEIDMAN'S 1953-1939"].

¹⁶ Section 170(b)(1)(A) organizations are primarily public charities, and certain private foundations. See Treas. Reg. § 1.170A-9. The included private foundations are described in § 170(b)(1)(E).

¹⁷ Treas. Reg. § 1.170A-8(d). Congress intended any gift in trust to be subject to the 30% limitation. Treas. Reg. § 1.170A-8(a)(2) defines gifts "for the use of" as a contribution of an income interest in property. See *Rockefeller v. Commissioner*, 676 F.2d 35 (2d Cir. 1982); see also Rev. Rul. 84-61, 1984-1 C.B. 39.

¹⁸ I.R.C. § 170(c)(3).

Finally, section 170(b)(1)(C) provides special limitations with respect to charitable contributions of capital gain property.

There are several policies which could explain the income tax deduction for charitable contributions.²¹ One often-stated justification is that taxpayers relieve government burdens by supporting charitable organizations, and therefore should not be taxed on their contributions.²² Morality provides another justification for the charitable deduction: encouraging voluntarism and philanthropy helps create a more ethical society.²³ Similarly, pluralism provides a rationale for allowing a charitable deduction: allowing private citizens to develop and support their individual interests creates a more heterogenous society.²⁴ Finally, there is a tax theory argument which is premised on the notion that individuals should only be taxed on income they consume. A charitable gift is not actual consumption. Therefore, it should not be taxable. Proponents of this theory also maintain that the effect of the deduction is to deprive the government of revenue, and therefore in essence to provide a government subsidy for the charitable organization.²⁵

In 1992, individuals contributed inter vivos gifts of \$101.83 billion to charitable organizations, or 81.9% of all contributions.²⁶ However, it is unclear how much of a role the charitable deduction actually plays in

¹⁹ IRC. § 170(c)(5).

²⁰ IRC. § 170(c)(4).

²¹ See generally Dean Pappas, *The Independent Sector and the Tax Laws: Defining Charity in an Ideal Democracy*, 64 S. CAL. L. REV. 461 (1991).

²² See *McGlotten v. Connally*, 338 F. Supp. 448, 456 (D.D.C. 1972).

²³ See James J. McGovern, *The Exemption Provisions of Subchapter F*, 29 TAX LAW. 523, 526 (1976).

²⁴ See E. Rabin, *Charitable Trusts and Charitable Deductions*, 41 N.Y.U. L. REV. 912, 920-25 (1966).

²⁵ See generally William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309 (1972).

²⁶ AAFRC REPORT, *supra* note 4, at 10.

individuals' charitable activities. Many taxpayers contribute to charities but do not itemize their deductions. For them, the charitable deduction provides no benefit and, therefore, no incentive to give. Nonetheless, the charitable deduction does play a role in many taxpayers' decisions, and this Article will focus on the deduction rather than on motives and incentives for charitable activity generally.

A) Statutory Restrictions and International Giving

Most of the above justifications for the charitable deduction can apply to deductions for gifts to foreign organizations as well as domestic ones.²⁷ In fact, the first Revenue Acts, from 1917 to 1935, did not impose any geographic limitation on the charitable deduction, allowing the deduction for contributions to all organizations. The Revenue Act of 1921²⁸ initiated deductions for contributions to the United States and its political subdivisions; the Acts of 1924, 1926, 1928, 1932 and 1934 made no changes regarding gifts to foreign donees.

However, the Revenue Act of 1935²⁹ imposed a geographic limitation on the corporate charitable deduction, allowing it only for donations to domestic entities, and only if the funds were used domestically.³⁰ Congress extended this limitation to apply to individual taxpayers in the Revenue Act of 1938,³¹ restricting the charitable gift deduction to "domestic" recipients. Citing the corporate deduction restriction contained in the Revenue Act of 1935, the House of Representatives' Ways and Means Committee justified the new geographic restriction by claiming that taxpayers should receive

²⁷ See Victoria B. Bjorklund, *International Philanthropy: Exploring New Ways to Accomplish International Goals, Including Activities of U.S. Charities Abroad*, 21 N.Y.U. CONF. ON TAX PLAN. FOR 501(C)(3) ORGS. §8 (1993).

²⁸ Revenue Act of 1921, Pub. L. No. 67-98, § 214(a)(11), 42 Stat. 227 (1921).

²⁹ Revenue Act of 1935, Pub. L. No. 74-407, § 102(r), 49 Stat. 1014 (1935).

³⁰ See *infra* text accompanying notes 135-141.

³¹ Revenue Act of 1938, Pub. L. No. 75-554, § 23(o), 52 Stat. 447 (1938).

charitable deductions only when their gifts relieve part of the government's burden. Their report stated that:

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.³²

The Committee thus relied solely on the government burden justification for the charitable gift deduction, but nonetheless acknowledged that "some portion" of the funds could be used abroad.

The Ways and Means Committee's explanation is unsatisfactory for several reasons.³³ As we have seen, there are many other possible justifications for the charitable deduction; the government itself has provided deductions for contributions which may not relieve the government's burden. Deductions for gifts to religious institutions provide the most notable example: they do not relieve government burdens,³⁴ although in addition to their spiritual purposes many also fulfill community support roles.

³² H.R. REP. NO. 1860, 75th Cong., 3d Sess. (1938), reprinted in SEIDMAN'S 1953-1939, *supra* note 15, at 17.

³³ See Harvey P. Dale, *Foreign Charities*, 48 TAX LAW. 655 (1995), for additional discussion of the flaws in the Committee's explanation.

³⁴ In fact, the Establishment Clause of the First Amendment requires that religious and government functions be wholly separate, protecting religious institutions from government entanglement, and protecting the nation from an establishment of religion. U.S. CONST., amend. I, § 3.

Furthermore, contributions to foreign organizations may assist the United States. The United States's foreign policy has long included aid to foreign countries, from the post-World War II Marshall Plan to humanitarian aid given to Somalia and other countries in need.³⁵ Individual citizens could aid such policy by contributing independently to foreign charitable organizations. Finally, morality, pluralism, and other rationales could be equally valid and applicable to deductions for contributions to foreign charities.

Historical and political realities might explain the Ways and Means Committee's decision. Congress may have been afraid of losing too much revenue, especially during the Depression's economic crisis. In addition, isolationism dominated United States foreign policy in the 1930's; Americans feared another European war and wanted at all costs to be separated from the tensions brewing on that continent.³⁶ Similarly, as communism, fascism, and Nazism gained power abroad, Congress may have feared that these movements would gain footholds in America.³⁷ Congress may therefore have seen the imposition of a geographic limitation on charitable gift deductions as a disincentive to American involvement in such dangerous movements. Congress made a similar argument in 1950, when it passed an amendment to the Code prohibiting deductions for contributions to or for the use of any Communist organization.³⁸ The House Committee on UnAmerican Activities reported that:

³⁵ See THOMAS J. MCCORMICK, *AMERICA'S HALF CENTURY: UNITED STATES FOREIGN POLICY IN THE COLD WAR* 7-12 (1989) (describing the "domestic context for hegemony" and its impact on foreign policy decisions).

³⁶ See WILLIAM E. LEUCHTENBERG, *FRANKLIN D. ROOSEVELT AND THE NEW DEAL* 197 (1963).

³⁷ For example, Louisiana's Huey Long created anxiety about fascism in the American South, Father Coughlin's radio broadcasts seemed to inspire many listeners, and in 1939, 22,000 Americans rallied in Madison Square Garden in support of the German-American Bund. See LEUCHTENBERG, *supra* note 36, at 275-86 (describing fascism in the United States in the 1930's).

³⁸ HR. REP. NO. 2980, 81st Cong., 2d Sess. (1950), *reprinted in* SEIDMAN'S 1953-1939, *supra* note 15, at 1368. Today, exempt status is still denied to Communist-controlled organizations. Treas. Reg. § 1.501(k)-1.

A careful analysis of the strategy and tactics of communism in the United States discloses activities by reason of which the committee has concluded that legislation can and should be directed toward . . . denying of income-tax deductions and exemptions in the case of contributions made to or for the use of any Communist organization.³⁹

Thus, it is also possible that in 1935, as in 1950, Congress decided that foreign policy "strategy and tactics" required prohibiting the charitable deduction for contributions made to foreign organizations.⁴⁰

Another example illustrating the use of the charitable deductions to further United States foreign policy occurred following World War II when the United States made great efforts to aid European reconstruction. The Trading With The Enemy Act,⁴¹ enacted in 1917, prohibited all but humanitarian aid to be donated to foreign enemy organizations.⁴² Following World War II, however, a proposal was made to amend the Act to allow charitable contributions to be made for the use of German organizations in rebuilding U.S.-occupied Germany.⁴³

The hearings regarding the proposed amendment reveal a desire to aid Germany in reconstruction in order to prevent the economic catastrophe which had followed World War I and helped lay the foundation for World War II. Congress thus saw aiding a foreign

³⁹ H.R. REP. NO. 2980, 81st Cong., 2d Sess. (1950), reprinted in SEIDMAN'S 1953-1939, *supra* note 15, at 1368.

⁴⁰ On the other hand, note that Congress did lift the place-of-use restriction on corporate donations during World War II.

⁴¹ 50 U.S.C.A. App. §§ 1-44 (West 1990). See *infra* Part VII and Appendix I for a detailed discussion of non-tax restrictions on charitable donations to foreign organizations.

⁴² 50 U.S.C.A. App. § 38(a) (West 1990).

⁴³ *A Bill to Amend the Trading with the Enemy Act, as amended, so as to Permit American Citizens, and Charitable, Religious, and other Non-Profit Organizations to Make Donations for Use in the Repair of War Damage in Any Area of Germany Occupied by or under the Control of the United States: Hearings on S. 2124 Before the Subcomm. of the Senate Comm. on the Judiciary, 80th Cong., 2d Sess. (1948).* Ultimately, the bill was not passed.

country as a worthy goal.⁴⁴ Accordingly, Congress did not implement the charitable gift deduction solely to reward those who took on domestic "government burdens," but relied on many different justifications.

Even in 1938, however, when Congress passed the original amendment geographically restricting individuals' charitable deductions, it failed to do so with absolute consistency. Despite the historical and political realities of the 1930s, Congress still allowed deductions for money *used* abroad. The 1938 Ways and Means Committee explained that:

[I]f the recipient . . . 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.⁴⁵

Thus, although individuals could not give directly to foreign organizations, they were allowed deductions for gifts to American organizations which then used the contributions abroad.

The Code's conflict between direct and indirect contributions permeates this area of tax law today. Code section 170(c) requires the donee organization to meet four requirements in order for the donor to receive a charitable contribution deduction. The first of these is that donee organization must be created in the U.S.⁴⁶ Thus, *Welti v.*

⁴⁴ The hearings also illustrate the role played by local constituents of German background, who wanted to support Germany after the war ended. One witness, for example, testified that "there are millions of German-American citizens whose kinfolk must live in the rubbles [sic] of the cities of ruins In silent resignation, these citizens have waited for three long years, now passed, since the end of the war, for permission to send money donations, materials and goods and offer their free services in the rehabilitation of their old homeland" *Id.* (statement of Siegfried Goetze, retired architect, Monrovia, MD).

⁴⁵ H.R. REP. NO. 1860, 75th Cong., 3d Sess. 17, *reprinted in* SEIDMAN'S 1953-1939, *supra* note 15. Compare the restriction on corporate donations to domestic donees which are then used abroad, *infra* text accompanying notes 135-141.

⁴⁶ Among other requirements, the statute also requires that the organization have a charitable purpose, I.R.C. § 170(c)(2)(B), *see supra* text accompanying notes 9-11, and prohibits any benefit to a private shareholder or individual through inurement to insiders,

Commissioner⁴⁷ held that deductions for donations to the First Church of Christ, Scientist, located in Berne, Switzerland, were not allowed, despite the fact that the "Mother Church" of Christ, Scientist was separately incorporated in Boston, Massachusetts. *Walti* held that the "clear meaning" of the Revenue Act of 1938, section 23(o) prohibited such a donation. Similarly, *ErSelcuk v. Commissioner*⁴⁸ held that an American professor on a Fulbright scholarship in Burma could not deduct donations to Burmese charities because the charities were not created in the U.S.

However, as stated above, contributions may be used outside the United States without affecting the deduction. Treasury regulations allow deductions for contributions "even though all, or some portion, of the funds of the organization may be used in foreign countries for charitable or educational purposes."⁴⁹ This legal precept was upheld in *Bilingual Montessori School of Paris v. Commissioner*.⁵⁰ In *Bilingual Montessori*, the Tax Court held that donations to a school incorporated in the U.S. but operated in France were deductible because: (1) the school was organized and incorporated in the U.S., and (2) the U.S. organization directly received the donations.

B) Earmarking and Conduit Restrictions

It is difficult to reconcile *Bilingual Montessori* with another set of limitations on deductions for contributions to foreign organizations, namely the earmarking and conduit restrictions.⁵¹ The Internal

IRC § 170(c)(2)(C). In addition, the organization's participation in lobbying is severely limited, and its participation in political campaigns is prohibited altogether. IRC § 170(c)(2)(D).

⁴⁷ 1 T.C. 905 (1943).

⁴⁸ 30 T.C. 962 (1958).

⁴⁹ Treas. Reg. § 1.170A-8(a)(1).

⁵⁰ 75 T.C. 480 (1980).

⁵¹ Internal Revenue Service, Exempt Organizations Continuing Professional Education Technical Instruction Program for Fiscal Year 1992 227 (1991) ["1992 EOCPE"] suggests exercising caution when relying on *Bilingual Montessori School* because of this conflict.

Revenue Service (the "Service") prohibits individuals from "earmarking" deductible contributions to section 170(c) organizations to the extent that such contributions result in a prohibited *de facto* gift to a non-U.S. organization. It defines prohibited earmarking as a situation in which a true gift has not been made because the contributor, and not the organization, retains control over how the organization will use the funds.⁵² The Service also denies the charitable deduction for contributions to those organizations deemed conduits for foreign organizations. Conduits are defined as qualifying domestic organizations in which funds "[come] to rest momentarily"⁵³ before being passed on to foreign donees selected by donors. Both of these restrictions attempt to implement the section 170(c)(2)(A) requirement that recipients of deductible charitable donations be domestic organizations.⁵⁴

The Service first announced its prohibition on donor earmarking of deductible contributions in Revenue Ruling 62-113.⁵⁵ That Ruling concludes that the charitable deduction is only allowed where a gift is intended for the use of an organization, and not where it is intended for the use of an individual.⁵⁶ The earmarking test examines whether the organization has full control of funds and discretion as to their use so as to ensure that the funds will be used to carry out the organization's functions and purposes.⁵⁷ In Revenue Ruling 62-113, an adoption

⁵² Rev. Rul. 63-252, 1963-2 C.B. 101. See also notes 186-195 *infra* and accompanying text, discussing control and discretion requirements of I.R.C. § 501 (c)(3) organizations. Note that an organization can solicit for projects that it has approved in advance and individuals can claim tax deductions for amounts paid directly for those projects.

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ 1962-2 C.B. 10.

⁵⁶ *Id.* See also *S.E. Thomason v. Commissioner*, 2 T.C. 441, 443 (1943), holding that a donation to an orphanage for a particular child's care was not deductible because "[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" (citations omitted).

⁵⁷ See, e.g., Gen. Couns. Mem. 33,619 (Sept. 14, 1967) (holding that donations to a scholarship fund were not deductible because the donations were made to a particular

agency received gifts from a soon-to-be adoptive parent of one of its wards. The Service held that these gifts were earmarked for use toward the particular child's well-being, rather than toward the institution as a whole. Because the institution lacked the requisite discretion and control over the donated funds, the gifts did not qualify for the charitable contribution deduction under Code section 170(c).

Revenue Ruling 63-252⁵⁸ and Revenue Ruling 66-79⁵⁹ apply the same test to donations to U.S. exempt organizations, earmarked by the donor for particular foreign charities. Revenue Ruling 63-252 concludes that donations earmarked for a specific recipient must be carefully examined, not only to determine whether the immediate domestic recipient is a qualifying organization, but also to determine whether the domestic recipient has control over the contribution.⁶⁰ So long as the domestic organization, and not the foreign organization, is the "real beneficiary" of the contribution, the contribution is deductible.⁶¹

Revenue Ruling 66-79⁶² describes a domestic exempt organization which qualified for deductible contributions under Code section 170(c)(2), and whose "name suggest[ed] a purpose to assist a named foreign organization."⁶³ The organization solicited contributions to provide grants to the named foreign organization. The ruling holds that contributions to the organization were deductible because the organization exercised "control and discretion as to the use of the

student, not "to or for" the college, thus failing to meet the educational purpose requirement included in § 170(c)(2). *But see* Gen. Couns. Mem. 39,748 (Aug. 3, 1988) (allowing contributors to advise § 501(c)(3) organizations on how they want funds to be distributed, as long as the funds are designated for domestic organizations and not for individuals or foreign organizations).

⁵⁸ *See supra* note 52.

⁵⁹ 1966-1 C.B. 48.

⁶⁰ *See supra* note 52.

⁶¹ *Id.*

⁶² *See supra* note 59.

⁶³ *Id.*

contributions received by it.⁶⁴ The ruling explains that in a qualifying donation,

contributions to the domestic organization are not earmarked in any manner for a foreign organization and the use of such contributions is subject to control by the domestic organization. For these reasons, the domestic organization is considered to be the recipient of the contributions within the meaning of section 170(c)(2) of the Code.⁶⁵

Consequently, donor earmarking appears impermissible only if the donor controls the donee's application of the funds. However, if the organization itself decides where the money ultimately will be used, the contribution is deductible, even in a situation where, as here, a contributor understands from the name of the organization that the funds will likely be used abroad for the benefit of a particular overseas organization.⁶⁶

Similarly, the Service generally takes the position that contributions are not deductible if they are made to an organization which immediately channels the funds to a foreign organization without exercising any discretion.⁶⁷ This would clearly circumvent the intent of the Code's geographic restriction. Revenue Ruling 63-262 states that:

the requirements of section 170(c)(2)(A) would be nullified if contributions inevitably committed to go to a foreign organization were held to be deductible solely because, in the

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ The organization described in the ruling was a "friends of" organization, discussed more fully *infra* notes 76-91, and accompanying text.

⁶⁷ *But see infra* text accompanying notes 76-91.

course of transmittal to the foreign organization, they came to rest momentarily in a domestic organization.⁶⁸

In such a case, the Service considers the domestic intermediate organization to be "a mere conduit"⁶⁹ and not the real donee. By prohibiting the charitable contribution deduction for contributions to "mere conduits" which will transfer the money to foreign donees, the Service thus prohibits the individual from indirectly accomplishing what the Code directly forbids: claiming a deduction for a charitable contribution to a foreign organization.⁷⁰

In Revenue Ruling 66-79,⁷¹ the Service articulates a test for determining whether a domestic organization is a conduit for a foreign organization. The test involves assessing the domestic organization's control and discretion as to use of contributions. In terms of individual deductions, "control and discretion" means that an individual may not exercise so much control over the organization that he or she effectively determines the domestic organization's use of the funds.

*Peace v. Commissioner*⁷² illustrates how an organization's control and discretion over its funds could enable a taxpayer to claim a charitable deduction even when the taxpayer had targeted the contribution for a particular use. In *Peace*, the court held that donations designated for specific missionaries in an African mission were deductible because they went into a general fund over which the mission had complete control.⁷³ The organization thus was not a "mere

⁶⁸ See *supra* note 52.

⁶⁹ *Id.*

⁷⁰ But see discussion of "friends of" organizations *infra*, notes 76-91, and accompanying text.

⁷¹ See *supra* 59.

⁷² 43 T.C. 1 (1964).

⁷³ *Peace* failed to take into account the donor's intent, which appeared to be to support specific, named missionaries. However, in other situations, intent has been considered. See Gen. Couns. Mem. 33,619 (Sept. 14, 1967) (discussing the "intended benefit" test, which bars a deduction intended to benefit a person or organization which is not a qualified

conduit," nor was it required to comply with the individual's attempt to earmark. The Service therefore permitted the taxpayer to take a deduction.

Revenue Ruling 75-65⁷⁴ provides another example of a deductible contribution to an organization which uses the funds abroad. This ruling discusses a domestic organization with tax-exempt status under section 501(c)(3), organized to protect wildlife in a foreign country. The organization was found to maintain control and discretion over its funds by making field investigations and requiring a written agreement prior to funding projects. Contributions thus qualified for deduction.⁷⁵

These rulings and cases attempt to enforce the Code enacted by Congress. They reveal that the statute's own inconsistencies have spawned seemingly inconsistent policies and formalistic tests. "Friends of" organizations, such as the organization described in Revenue Ruling 66-79,⁷⁶ provide one example of such a policy. A "friends of" organization is a charitable organization set up in the United States specifically in order to assist another, typically foreign, charitable organization. "Friends of" organizations seem, without close analysis, to contradict Congress's original goal of rewarding only those donors who contribute to domestic charitable organizations. However, the donor is

donee); Archibald v. McMillan, 31 T.C. 1143 (1959) (taxpayer not allowed to take a deduction for contribution to an adoption agency prior to adopting a child, because his intent was not to benefit the agency, but rather to benefit himself and his soon-to-be adopted child). See also Mozelle C. Kluss, 46 T.C. 572 (1966), involving a reverse conduit, where a non-charitable organization used an individual's contribution to send literature to I.R.C. § 170(c) organizations. Because the court found that the donor intended to benefit the organization to which he gave, rather than the ultimate charitable recipients, he was not allowed the deduction.

⁷⁴ 1975-1 C.B. 79.

⁷⁵ However, donations to organizations jointly organized by the U.S. and a foreign country ("binational" organizations) are not deductible under § 170(c)(1) because they are not considered gifts "to or for the United States." Rev. Rul. 76-195, 1976-1 C.B. 61; Gen. Couns. Mem. 35,485 (Sept. 20, 1973). Gifts to international organizations established by treaty or executive agreement also are not deductible, for the same reason. Finally, 22 U.S.C. § 809(e) allows individuals a deduction for donations to the State Department earmarked for these types of international organizations if the State Department determines that such a donation is for its own benefit.

⁷⁶ See *supra* note 59.

in fact, giving to a domestic organization that exercises discretion and control over the donated funds. Although this result may appear to be inconsistent with Congress' original goal, this scheme may provide a rational method for dealing with the statute's shortcomings.

Revenue Rulings 63-252⁷⁷ and 66-79⁷⁸ approve section 170 deductions for contributions to "friends of" organizations which assist foreign organizations, even though the structure of the "friends of" organization seems to violate the earmarking and conduit restrictions. Although it would appear that a taxpayer who decides to donate money to the Friends of Hebrew University, for instance, is in fact earmarking his or her money to benefit a foreign organization, such a donation is deductible, provided that the domestic organization is otherwise properly organized and operated to qualify under section 170(c).⁷⁹

The Service attempts to overcome this apparent contradiction by using control and discretion analysis. Revenue Rulings 63-252 and 66-79 find that "friends of" organizations exert sufficient control and discretion over the use of their funds such that donations to such organizations qualify for the charitable deduction.⁸⁰ Recent decisions have continued to maintain that "control and discretion" qualifies domestic organizations which aid foreign organizations. Examples of such organizations include an amateur basketball association promoting basketball in a foreign country,⁸¹ a domestic organization which gives

⁷⁷ See *supra* note 52.

⁷⁸ See *supra* note 59.

⁷⁹ See *supra* note 59.

⁸⁰ See *supra*, notes 52, 59. The requirements "control and discretion" place on an organization are described *infra* notes 186-195 and accompanying text.

⁸¹ Priv. Ltr. Rul. 9129040 (Apr. 23, 1991). Although the Code specifies in § 6110(j)(3) that "[u]nless the Secretary otherwise establishes by regulations, a written determination may not be used or cited as precedent," it is clear that private letter rulings are often useful indications of the Service's position on a particular issue. For additional discussion regarding the precedential value of private letter rulings, see Gerald G. Portney, *Letter Rulings: An Endangered Species?*, 36 TAX LAW. 751 (1983); James P. Holden & Michael S. Novey, *Legitimate Uses of Private Letter Rulings Issued to Other Taxpayers - A Reply to Gerald Portney*, 36 TAX LAW. 751 (1983).

money to needy students in a foreign country for music lessons,⁸² and a domestic organization which gives money to some of a foreign country's needy families randomly selected from a list of 5,000 families provided by a foreign non-governmental organization.⁸³ These exempt organizations were all found to meet control and discretion requirements, thus allowing taxpayers to deduct contributions to the organizations.

C) Conclusion

It may seem contradictory on the part of the Service to enforce a restriction on individual gifts made directly to foreign organized charities, but to allow "friends of" organizations to facilitate such gifts, particularly since achieving "friends of" status is relatively simple. However, faced with a contradictory statute provided by Congress, the Service was forced to develop a means to enforce it, and the tests the Service developed do serve some purpose. Requiring that the charity or foundation be organized in the United States does provide some assurance that the foreign charitable recipient in fact operates exclusively for charitable purposes. To qualify for exemption under section 170(c)(2), an organization must apply for recognition of its exempt status.⁸⁴ The organization must meet certain requirements: its purpose must be one of the exempt purposes described in section 501(c)(3),⁸⁵ it must have appropriate governing instruments describing its exempt purpose;⁸⁶ it may not be empowered to engage

⁸² Priv. Ltr. Rul. 8622011 (Feb. 26, 1986).

⁸³ Priv. Ltr. Rul. 8916041 (Jan. 23, 1989).

⁸⁴ I.R.C. § 508(a). Section 508(c) and Treas. Reg. § 1508-1(a)(3)(ii)(b) exempt certain organizations from these requirements, including religious organizations and organizations which are not private foundations and whose gross profits are not more than \$5,000. All other organizations seeking exempt status must file Form 1023.

⁸⁵ I.R.C. § 501(c)(3); Treas. Reg. § 1501(c)(3)-1(a).

⁸⁶ Treas. Reg. § 1501(c)(3)-1(b)(1)(i)(a).

substantially in any non-exempt purpose,⁸⁷ it must submit a detailed statement of its proposed activities,⁸⁸ and its assets may not be distributed to shareholders or members.⁸⁹ These restrictions give the Service some basic information and reassurance that the ultimate foreign recipient is in fact pursuing a legitimate exempt purpose.

In addition, Revenue Ruling 63-252 requires that the U.S. "friends of" donee not be bound to transfer the funds to a foreign entity by virtue of a charter or by-law provision, that gifts made by the U.S. donee to the foreign entity be within the charitable mission and purpose of the U.S. entity, and that the U.S. donee exercise some scrutiny over the foreign donee, to ensure that it, in turn, is an eligible charity within the meaning of Code section 501(c)(3).⁹⁰ Finally, the conduit restriction helps assure that a charitable organization is in fact the donee of contributions and not an agent for a foreign organization. It also helps to assure that the ultimate beneficiary of donated funds will use those funds for charitable purposes.

Thus, the Service has devised a mechanism to enforce the statute Congress provided. The "earmarking" and "conduit" tests do help resolve the tensions inherent in the Code between the prohibition against direct gifts to foreign organizations, and the allowance that U.S. organizations use charitable donations abroad.

III) Transfer Taxes: Gift and Estate Tax Charitable Deductions

In addition to claiming an income tax deduction for charitable contributions, an individual or an estate also may claim a charitable deduction under the gift⁹¹ and estate⁹² taxes. In these sections of the

⁸⁷ Treas. Reg. § 1501(c)(3)-1(b)(1)(i)(b).

⁸⁸ Treas. Reg. § 1501(c)(3)-1(b)(1)(v).

⁸⁹ Treas. Reg. § 1501(c)(3)-1(b)(4); Treas. Reg. § 1501(c)(3)-1(c)(2) also prohibits any private inurement. For a more detailed analysis of the requirements private and public exempt organizations must fulfill to maintain their exempt status, see *infra* Section V.

⁹⁰ See Dale, *supra* note 33, at 662-63.

⁹¹ IRC. § 2522(a).

Code, there is no geographic restriction on deductions for charitable contributions.

The Code does not provide a specific definition of "gift" in the provisions which delineate the gift tax, although several sections describe certain types of gifts.⁹³ However, it does describe a gift's valuation:

Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift.⁹⁴

Charitable contributions fall under this category. Thus, Code section 2522(a)(2) allows United States citizens or residents a deduction from the gift tax for the amount of all gifts made to or for the use of certain organizations described as charitable.⁹⁵

The gift tax deduction is not limited to gifts used within the United States, or to gifts to or for the use of domestic organizations.⁹⁶

⁹² I.R.C. § 2055(a)(2).

⁹³ See I.R.C. §§ 2511-2519; RICHARD B. STEPHENS ET AL., FEDERAL ESTATE AND GIFT TAXATION § 9.04 (5th ed. 1983).

⁹⁴ I.R.C. § 2512(b). In addition, I.R.C. § 2503(b) excludes the first \$10,000 of gifts from taxation. The Supreme Court has read this language as part of the statutory definition of the term "gift." *Commissioner v. Wemyss*, 324 U.S. 303, 306 (1945). See also STEPHENS, *supra* note 94, at § 10.02[3].

⁹⁵ These organizations include: 1) the United States, its political subdivisions, and the District of Columbia; 2) corporations, trusts, community chests, funds, or foundations organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art, the fostering of national or international amateur sports competition, and the prevention of cruelty to children or animals; 3) a fraternal society, order, or association, operating under the lodge system, provided that the gift's use is restricted to religious, charitable, scientific, literary, or educational purposes; 4) posts or organizations of war veterans or auxiliary units or societies of any such posts or organizations, organized in the United States or its possessions. I.R.C. § 2522(a)(1)-(4).

⁹⁶ Treas. Reg. § 25.2522(a)-1(a)(4) does not limit the deduction to gifts to domestic corporations, trusts, community chests, funds or foundations, or fraternal organizations.

Thus, the issue of deductibility for contributions to foreign organizations disappears.⁹⁷ As far as the gift tax is concerned, taxpayers can donate money to whomever they wish, as long as the organization meets the qualifications of a charitable organization under Code section 2522. This illustrates yet another inconsistency within the Code. The expansive gift tax charitable deduction contradicts the "government burden" policy stated in the 1938 legislative history.⁹⁸ It is difficult to discern a rational theory for allowing the deduction under the gift tax but prohibiting it under the income tax.

Similarly, the estate tax provides a deduction for bequests to charitable organizations. Code section 2055(a)(2) specifies that the deduction applies to a contribution "to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art, or to foster national or international amateur sports competition. . . ." Code section 2055(a)(3) lists these same purposes as acceptable for donees that are trustees and fraternal organizations. Like the gift tax Code provisions, the estate tax sections also fail to mention organizations which engage in testing for public safety. The estate tax regulations also prohibit deductions for bequests to organizations engaged in prohibited transactions.⁹⁹ Finally, section 2055 of the estate tax, like section 2522(a) of the gift tax, does not limit such transfers to domestic

⁹⁷ The only issue involving contributions to foreign organizations which the Code explicitly addresses is whether the foreign donee receives substantial support from foreign sources and has engaged in a "prohibited transaction," as per § 4948(c)(4). Treas. Reg. § 25.2522(c)-2(c). Deductions for donations to such organizations, like those to domestic organizations which engaged in prohibited transactions, are prohibited, provided that the gift is made: 1) after the Commissioner publishes notice of and notifies the organization that it engaged in a prohibited transaction, or 2) in a year for which the organization is not exempt under § 501(a) because it has engaged in a prohibited transaction.

A "prohibited transaction" is defined in § 4948(c)(2) as "any act or failure to act . . . which would subject a foreign organization . . . to liability for a penalty under section 6684 or a tax under section 507 if such foreign organization were a domestic organization." I.R.C. § 4948(c)(2).

⁹⁸ See *supra* text accompanying note 32.

⁹⁹ Treas. Reg. § 20.2055-5(c); see *supra* note 98.

organizations.¹⁰⁰ For this reason, many of the issues discussed above regarding the income tax charitable deduction disappear in the context of the estate tax charitable deduction as well.¹⁰¹

It is much easier for individuals to contribute to foreign charities under estate tax and gift tax regimes than under the income tax regulations.¹⁰² The "government burden" rationale for limiting deductions for contributions to foreign charities disintegrates under the gift and estate taxes. However, no other theory is substituted to explain why the geographic limitation which the income tax imposes falls away here. The estate tax provision may provide an incentive for individuals to defer their charitable gifts to foreign organizations until after death. It is not clear why such an incentive should exist, or how effective it is. Furthermore, the inconsistencies between and within these sections are confusing and cumbersome. The estate and gift tax

¹⁰⁰ Treas. Reg. § 20.2055-1(a)(4). Treas. Reg. § 20.2055-1(a)(4) also states that the estate tax deduction is not subject to percentage limitations like those imposed by the income tax.

¹⁰¹ The most significant controversy which emerged over deductions for donations to foreign organizations developed from § 2055(a)(1), which permits a charitable deduction for bequests to political subdivisions. At first, this section was construed to apply only to United States government subdivisions, and not to those of foreign countries. See *Edwards, Lloyd, Ex'r. (Hansen) v. Phillips*, 373 F.2d 616 (10th Cir.), *cert. denied*, 389 U.S. 834 (1967). However, this position was later overruled to permit deductions for bequests to foreign political subdivisions, provided that the bequest specified a charitable use. See *Kaplun v. United States*, 436 F.2d 799 (2d Cir. 1970); *Old Colony Trust Co. v. United States*, 438 F.2d 684 (1st Cir. 1971). The Service officially accepted these decisions in Revenue Ruling 74-523, 1974-2 C.B. 304. See also Gen. Couns. Mem. 35,777 (Apr. 10, 1974). For a more detailed discussion of this issue, see 1992 EOCPE, *supra* note 51, at 231.

¹⁰² There are many inconsistencies between and within the gift tax and estate tax provisions. For example, under the gift tax provisions, contributions to a trustee of an organization that encourages art are deductible. I.R.C. § 2522(a)(2). However, under the estate tax provisions, such a contribution is not deductible. See I.R.C. § 2055(a)(3). In this regard, the estate tax is internally inconsistent. I.R.C. § 2055(a)(2) allows deductions for contributions to corporations organized for the encouragement of art or to foster amateur sports competition. However, § 2055(a)(3) does not include the encouragement of art or the fostering of amateur sports as qualified purposes for trusts, fraternal societies, orders or associations operating under the lodge system. These inconsistencies may simply be the result of faulty drafting. Nonetheless, they create much confusion. See generally Dale, *supra* note 33.

sections thus highlight the Code's contradictory handling of deductions for individual charitable donations to foreign organizations.

IV) Corporate Charitable Giving

In addition to the deduction provided for individuals, section 170 provides a deduction for charitable contributions by corporations.¹⁰³ However, the history behind the two provisions differs. Certain limitations, including stricter percentage limitations,¹⁰⁴ exist with respect to corporate international giving, but do not affect giving by individuals.

Congress first provided a federal income tax deduction for corporate donations to charities in 1935, eighteen years after a deduction was granted to individuals. However, corporate philanthropy existed well before that time. In the late 1800s, the railroads worked with the Young Men's Christian Associations to provide housing for workers. By 1911, 113 buildings had been erected at a cost of over \$1.8 million, with the railroads providing more than half of the funds.¹⁰⁵ In response to World War I, 148 corporations declared a special "Red Cross dividend" requesting shareholder authorization to contribute the dividend to the Red Cross. Almost \$18 million was contributed in this manner.¹⁰⁶ During the 1920s, corporate annual contributions to community chests reached \$12 million.¹⁰⁷ Corporate philanthropy at this time was not restricted to domestic needs. For example, corporations contributed

¹⁰³ For a discussion of the organizations deemed "charitable" for purposes of § 170, see *supra* notes 8-10 and accompanying text.

¹⁰⁴ Corporate deductions are allowed for up to ten percent of taxable income, although a five year carryover is provided. I.R.C. § 170(b)(2), (d)(2); see also Barry D. Karl, *The Evolution of Corporate Grantmaking in America*, in THE CORPORATE CONTRIBUTIONS HANDBOOK 20, 30 (James P. Shannon ed, 1991) (original limit on corporate charity developed out of New Deal, Populist and Progressive era concerns about large corporations).

¹⁰⁵ PIERCE WILLIAMS & FREDERICK E. CROXTON, CORPORATE CONTRIBUTIONS TO ORGANIZED WELFARE SERVICES 52 (1930).

¹⁰⁶ *Id.* at 59.

¹⁰⁷ *Id.* at 93.

significantly to Red Cross Disaster Appeals in response to a Japanese earthquake in 1923 and a hurricane in the West Indies in 1928.¹⁰⁸

The income tax deduction enacted in 1935 did not have an immediate effect on the amount of corporate donations because corporate taxes were relatively low.¹⁰⁹ Corporate charitable contributions averaged about \$30 million a year during the late 1930s.¹¹⁰ However, with the imposition of the excess profits tax during World War II, contributions reached \$266 million in 1945.¹¹¹ After the war, contributions stabilized at over \$200 million a year and rose to \$300 million by 1951.¹¹² By 1992, corporate giving reached \$6 billion, or 4.8% of total charitable giving.¹¹³

One explanation offered for corporate charitable giving is based on the theory that corporations bear inherent responsibilities to society because of the protections they receive from the state and because of their dependence on the community.¹¹⁴ These social responsibilities often are described as part of a social contract which encompasses the generally accepted relationships, obligations and duties between major institutions and individuals.¹¹⁵ Fulfilling these social responsibilities also may be an attempt to legitimize corporate power and convince the

¹⁰⁸ *Id.* at 225, 227.

¹⁰⁹ F. EMERSON ANDREWS, CORPORATION GIVING 39 (1952) ["CORPORATION GIVING"].

¹¹⁰ F. EMERSON ANDREWS, FOUNDATION WATCHER 115 (1973) ["FOUNDATION WATCHER"].

¹¹¹ *Id.*

¹¹² CORPORATION GIVING. *supra* note 110, at 15.

¹¹³ AAFRC REPORT, *supra* note 4, at 10.

¹¹⁴ See *A.P. Smith Mfg. Co. v. Barlow*, 13 N.J. 145, 154, *appeal dismissed*, 346 U.S. 861 (1953) (corporations must acknowledge and discharge social as well as private responsibilities as members of community in which they operate); E. Merrick Dodd, Jr., *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1148 (1932) (public views corporations as having social service as well as profit-making functions); *id.* at 1149 (business is encouraged by law because it serves community); Karl, *supra* note 105 (corporations have inherent responsibilities that stem from dependence on "moral fundamentals of human settlement").

¹¹⁵ R. ERIC REIDENBACK & DONALD P. ROBIN, ETHICS & PROFITS 65 (1989).

public that such power is being used in an appropriate manner.¹¹⁶ A profit maximization theory suggests it is in a corporation's self-interest to provide services which benefit its employees and the community in which it operates.¹¹⁷ Corporate donations also may be seen as the purchase of business goodwill.¹¹⁸ Yet another explanation for corporate giving is that it gives corporations the ability to influence public policy without having to resort to the political process.¹¹⁹

Before the federal income tax deduction was granted in 1935, the debate over charitable contributions centered around two issues: (1) the types of benefits corporate officers could offer without their actions becoming ultra vires,¹²⁰ and (2) the types of contributions that could be deducted under the ordinary and necessary business deduction

¹¹⁶ See generally NEIL J. MITCHELL, *THE GENEROUS CORPORATION: A POLITICAL ANALYSIS OF CORPORATE POWER* (1989).

¹¹⁷ See *A.P. Smith*, 13 N.J. at 1147 (company president testified that contributions to liberal arts institution furthered self-interest of company in assuring properly trained personnel for corporate employment); Karl, *supra* note 105, at 21; cf. ROGER E. MEINERS & DAVID N. LABAND, *PATTERNS OF CORPORATE PHILANTHROPY: PUBLIC AFFAIRS GIVING AND THE FORBES 250*, at 9 (1988) ("[T]he first obligation of any company is to make a profit. Only a profitable company can employ the people of a community, thereby spreading economic and social benefits each and every payday to individuals who have earned them and giving the people the ability both to meet their own needs and to extend the gift of true charity to others").

¹¹⁸ See Dodd, *supra* note 115, at 1159; Nancy J. Krauer, *The Paradox of Corporate Giving: Tax Expenditures, the Nature of the Corporation, and the Social Construction of Charity*, 11 *THE EXEMPT ORG. TAX REV.* 1225 (June 1995) (arguing that socially responsible behavior has become profitable and analyzing the tax deduction as an indirect subsidy for the purchase of advertising services).

¹¹⁹ See Karl, *supra* note 105, at 22; see also FOUNDATION WATCHER, *supra* note 111, at 269 (charitable contributions are beneficial because decisions on use are made not by public but by the responsible and diverse judgment of trustees of receiving institutions); cf. Dodd, *supra* note 115, at 1162 (expecting corporate managers to conduct an institution for the benefit of classes whose interests are largely conflicting may impose an impossible task and grant dangerous powers).

¹²⁰ For an annotated list of cases detailing the validity, under state corporate law, of various donations, see CORPORATION GIVING, *supra* note 110, at 317-27.

contained in section 234(a)¹²¹ of the 1921 Revenue Act.¹²² The regulations under this section recognized the right to deduct payments "made by a corporation for purposes connected with the operation of its business . . . when limited to charitable institutions, hospitals or educational institutions conducted for the benefit of its employees," and payments "which legitimately represent[ed] a consideration for a benefit flowing directly to the corporation as an incident of its business." The regulation was retained without substantial change under the 1924, 1926, and 1928 Acts.¹²³ Thus, corporate donations had to satisfy stringent requirements under both state corporate law and federal tax law.¹²⁴

In 1918, Congress explicitly refused to extend the charitable contribution deduction from individuals to corporations.¹²⁵ The proposed deduction used precisely the same language that had been adopted the previous year providing a deduction for individuals.¹²⁶ At the time, Congress appeared to have assumed that these corporate contributions would be used abroad to help support American servicemen in Europe.¹²⁷ Those opposed to the deduction prevailed in their arguments that the money was not the corporate directors' to give; that such actions were *ultra vires*; that it was unnecessary to reward people every time they made a charitable contribution; and that it was more appropriate for companies to issue dividends to their shareholders

¹²¹ The business expense deduction is now codified at § 162.

¹²² Article 562 of Treas. Reg. 62, interpreting the 1921 Revenue Act, disallowed deductions for charitable contributions.

¹²³ Art. 562 of Treas. Reg. 65; Art. 262 of Treas. Reg. 74.

¹²⁴ For an annotated list of cases detailing the deductibility of various donations under the business expense provision, see CORPORATION GIVING, *supra* note 110, at 317-27.

¹²⁵ 56 Cong. Rec. 10,426 (1918). See also Karl, *supra* note 105, at 28 (describing how, although state legislatures moved by the war effort permitted corporate giving, Congress was not inclined to grant an income tax deduction).

¹²⁶ 56 Cong. Rec. 10,426 (1918).

¹²⁷ *Id.*

who could then contribute the money to the charities of their choice and take the available income tax deduction.¹²⁸

This debate was renewed in 1921, when the House adopted an amendment allowing corporations a deduction for corporate gifts to all charitable organizations, regardless of whether they were domestic or foreign, but limiting the deductibility of gifts made by foreign-organized corporations to gifts made to domestic corporations or to community chests, funds, or foundations created in the U.S.¹²⁹ The Senate refused to adopt the proposal.¹³⁰

In 1934, the Supreme Court decided *Old Mission Portland Cement Co. v. Helvering*¹³¹ holding that a business deduction for a company's gift to the San Francisco Community Chest could not be allowed. The gift was apportioned among the city's charities, and was made in the belief that it would increase goodwill toward the company as well as increase business. The Supreme Court determined that the gift did not constitute a direct benefit to Old Mission's employees or business as contemplated by Treasury Regulation 62. In response to this decision, a number of community chests began a lobbying campaign which culminated in the creation of section 23(r) of the Code, providing a deduction for corporate charitable contributions.¹³² The deduction was

¹²⁸ 56 Cong. Rec. 10,429 (1918).

¹²⁹ 61 Cong. Rec. 5,295 (1921).

¹³⁰ J.S. SEIDMAN, SEIDMAN'S LEGISLATIVE HISTORY OF FEDERAL INCOME TAX LAWS 1938-1861, at 288 (1938) ["SEIDMAN'S 1938-1861"].

¹³¹ 293 U.S. 289 (1934).

¹³² Section 23 of the Revenue Act of 1934 was amended as follows:

(r) Charitable and Other Contributions by Corporations.—In the case of a corporation, contributions or gifts made within the taxable year to or for the use of a domestic corporation, or domestic trust, or domestic community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or the prevention of cruelty to children (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 exclusively for such purposes), no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise

adopted over the public opposition of President Roosevelt and many Democratic members of Congress.¹³³

The Congressional response to *Old Mission* created problems of its own. Instead of expanding the concept of direct benefit and allowing a charitable contribution as a business expense deduction, Congress created a completely new deduction for corporations.¹³⁴

A) Restrictions on International Giving

The 1935 legislation provided for a corporate deduction "in . . . the case of contributions or gifts to a trust, chest, fund, or foundation, only if

attempting, to influence legislation; (2) to an amount which does not exceed 5 per centum of the taxpayers net income as computed without the benefit of this subsection; (3) such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary.

Revenue Act of 1935, Pub. L. No. 74-407, § 102 (c), 49 Stat. 1014, 1016 (1935). For the reasoning behind the final adoption of the proposal, see H.R. REP. (MINORITY) No. 1681, 74th Cong., 1st Sess. (1935):

We deem it a mistake not to have provided an exemption from the corporation income tax on gifts made by corporations to community chests and other charities. It is the announced policy of the administration to throw the burden of caring for unemployables back on the States and local communities If corporations are public spirited enough to make contributions to charities, we believe their contributions should be exempt from taxation exactly as is done in the case of individuals.

However, the statute did not treat corporations exactly as it did individuals. The individual deduction did not require that donations be made to domestic organizations, nor did it include a place-of-use restriction. Beginning in 1938, the individual deduction was restricted to donations to domestic organizations. However, donations by individuals have never been subject to the place-of-use restriction. See *supra* Part II.

¹³³ 79 Cong. Rec. 12,423 (1935).

¹³⁴ For further discussion of the differences between a charitable contribution and a business expense deduction, see *infra* text accompanying notes 143-146. Issues still arise over the distinction because the limitations which apply to corporate charitable donations do not apply to ordinary and necessary business expenses. For an argument that the charitable deduction should be eliminated and the business expense concept expanded to recognize that most donations are seen as a way to maximize profits, see Krauer, *supra* note 119.

such contributions or gifts are to be used within the United States. . . .¹³⁵ The place-of-use restriction still exists in the flush language of section 170(c)(2).¹³⁶ The restriction refers only to gifts by a corporation to a trust, chest, fund, or foundation, while the deduction itself is allowed for gifts to a domestic *corporation*, trust, chest, fund, or foundation. Early in the history of the deduction, the Service confirmed that gifts by a corporation to a domestic corporate donee could be used outside the United States without jeopardizing the U.S. income tax deduction.¹³⁷ It is unclear whether the distinction made by the Code between incorporated and unincorporated donees was the result of faulty drafting or an intentional compromise made by Congress.¹³⁸ The later legislative history discussing the disparate treatment between incorporated and unincorporated donees demonstrates only that Congress misunderstood the issue. In 1942, responding to the needs of World War II, the Senate offered to delete the place-of-use restriction. It seems the Senate thought that the restriction applied to all donees and did not except corporate donees. The Senate report states:

¹³⁵ Revenue Act of 1935, Pub. L. No. 74-407, § 102(c), 49 Stat. 1014, 1016 (1935).

¹³⁶ "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 . . ." IRC § 170(c)(2).

¹³⁷ Rev. Rul. 69-80, 1969-1 C.B. 65. This ruling restates LT. 3048, 1937-1 C.B. 85, *declared obs.*, Rev. Rul. 68-100, 1968-1 C.B. 572. The obsolescence of LT. 3048 does not change the legal rule. Priv. Ltr. Rul. 6810090140A (Oct. 9, 1968).

¹³⁸ The place-of-use restriction on domestic donees is a significant limitation on international philanthropy because corporations cannot receive a U.S. income tax deduction for direct donations to foreign charities. The definition of a charitable contribution is limited to a gift to or for the use of a U.S. or state governmental entity or a corporation, trust, chest, fund, or foundation created or organized under the law of the U.S. or any state. IRC § 170(c). However, bilateral treaties with Mexico, Canada and Israel allow a U.S. income tax deduction for direct contributions to charities organized in those countries. See *infra* Part VI.

Foreign subsidiaries of U.S. multinationals may wish to make contributions to organizations created in the country in which they are operating. The subsidiary may make the contribution directly to the organization and utilize whatever tax advantages are available in the particular country. In this case, U.S. tax laws are irrelevant. For a more extensive guide to making such donations, see JOHN A. EDIE, *BEYOND OUR BORDERS: A GUIDE TO MAKING GRANTS OUTSIDE THE U.S.* 13 (1994).

Under the existing law, a corporation is entitled to a deduction for charitable contributions only if such contributions are gifts to be used within the United States or any of its possessions by corporations, trusts, community trust funds, or foundations. . . . 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.¹³⁹

In any case, the House bill did not contain a similar provision and a compromise was reached allowing contributions to be used abroad only for the remainder of the war.

The compromise language implied that corporate donees had always been able to use their funds abroad. The final language read as follows:

But in the case of contributions or gifts to a trust, chest, fund, or foundation, payment of which is made within a taxable year beginning after the date of cessation of hostilities in the present war. . . only if such contributions or gifts are to be used within the United States or any of its possessions. . . .¹⁴⁰

Significantly, the list of donees enumerated at the time did not include corporate donees, presumably recognizing that deductions to such donees were allowed regardless of where they were used and that therefore an expansion due to the exigencies of the war was unnecessary.

The issue resurfaced in 1948, this time with the House attempting to eliminate the place-of-use restriction on corporate donations to unincorporated donees, but the bill was not acted upon by the Senate, and this limitation remains.¹⁴¹ Throughout all of these

¹³⁹ S. REP. NO. 1631, 77th Cong., 2d Sess. 51 (1942), *reprinted in* 1942-2 C.B. 504, 546.

¹⁴⁰ Revenue Act of 1942 Pub. L. No. 77-753, § 125, 56 Stat. 1529 (1942).

¹⁴¹ See I.R.C. § 170(c).

debates, Congress never provided an explanation for the different treatment of domestic corporations as opposed to trusts, funds and community chests.

The place-of-use restriction and the percentage limitation that apply to corporate donations do not apply to ordinary and necessary business expenses which are deductible under section 162. For this reason, the appropriate characterization of a payment as either a charitable contribution or a business expense has important consequences for the corporate donor.¹⁴² The distinction has generated a significant amount of litigation. In general, a corporation may deduct all of the ordinary and necessary expenses paid or incurred in carrying out its business.¹⁴³ However, no business expense deduction is allowed for "any contribution or gift which would be allowable as a deduction under section 170 were it not for the percentage limitations, the dollar

¹⁴² In some instances the characterization of income for purposes of the unrelated business income tax paid by the donee was thought to affect the characterization of the donor's deduction as either a charitable contribution or a business expense. An organization which is exempt from taxation under § 501(a) or (c) must pay tax on its unrelated business income. I.R.C. § 511. Such income is defined as arising from any trade or business which is not substantially related to the exercise or performance by the organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under § 501. Treas. Reg. § 1.513-1(a). In January 1993, the Service announced Proposed Regulation § 1.513-5, describing circumstances in which income from sponsorship payments would be treated as advertising income subject to the unrelated business income tax. However, the regulation specifically states that whether an activity constitutes unrelated business income to the donee does not determine whether a donor may deduct its payment under § 162 or § 170. In determining unrelated business income, the test is not whether there is a quid pro quo, which is the test for differentiating between § 162 and § 170 deductions, but whether the sponsorship constitutes advertising or mere acknowledgement. INTERNAL REVENUE SERVICE, 1994 EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION TECHNICAL INSTRUCTION PROGRAM 256 (1993). For further discussion of this topic, see *id.* at 244-60; David A. Haimes, *Corporate Sponsorship of Charity Events and the Unrelated Business Income Tax: Will Congress or the Courts Block the IRS Rush to Sack the College Football Bowl Games?*, 67 NOTRE DAME L. REV. 1079 (1992); see also *Attorneys Criticize Corporate Sponsorship Regulations*, TAX NOTES TODAY, July 29, 1993; *Corporate Sponsorship Sellout Puts IRS at Risk*, TAX NOTES TODAY, Sept. 22, 1993 (Viewpoint); *Sponsorship Regulations Deserve Cheers, Not Boos*, TAX NOTES TODAY, Oct. 8, 1993 (Letters to the Editor).

¹⁴³ I.R.C. § 162(a) (1993).

limitations, or the requirements as to the time of payment. . . .¹⁴⁴ Generally, if there is a reasonable expectation of an economic benefit commensurate with the amount paid, then the payment is deductible under section 162(a). If there is no expectation of such a benefit, the deductibility of the payment is determined according to section 170. In other words, if there is a sufficient quid pro quo, the donation should be treated as a business expense.¹⁴⁵ However, a quid pro quo sufficient to qualify a payment as a business expense need not involve a legally binding obligation on either the corporation or the donee and may involve only a voluntary payment made with the expectation or hope of increased business.¹⁴⁶

¹⁴⁴ IRC § 162(b) (1993).

¹⁴⁵ See generally *Quid Pro Quo*, 4 THE NATIONAL CENTER ON PHILANTHROPY AND THE LAW (forthcoming 1996).

¹⁴⁶ For examples illuminating the distinction between a charitable contribution under § 170 and a business expense under § 162, see *Singer Co. v. United States*, 449 F.2d 413 (Ct. Cl. 1971) (holding that while discounts to schools on sale of sewing machines were not charitable contributions because benefit derived by donor was substantial enough to constitute quid pro quo, discounts to other charities were deductible because benefits derived were merely incidental to the transfer); *Sarah Marquis*, 49 T.C. 695, *acq.*, 1971-2 C.B. 3 (binding obligation on part of recipient not necessary for contribution to come under § 162); *Van Iderstine Co. v. Commissioner*, 261 F.2d 211 (2d Cir. 1958) (payment made with the expectation or hope that it would promote business is a deductible business expense); Rev. Rul. 69-90, 1969-1 C.B. 63 (voluntary payments used by city to provide public parking deductible under § 170 where parking for public, not contributors, and contribution not based on proximity or probable use); Gen. Couns. Mem. 34,889 (May 26, 1972) (proceeds of "charity night" received by race track and distributed to charitable organization are deductible under § 170 and not § 162); Gen. Couns. Mem. 34,519 (June 7, 1971) (voluntary payment made with reasonable expectation of financial return commensurate with amount of payment is not a contribution under § 170, regardless of whether the recipient qualifies under § 170(c)); Gen. Couns. Mem. 33,910 (Aug. 16, 1968) (legally binding quid pro quo not always required for a payment not to be a contribution under § 170); Priv. Ltr. Rul. 7303071270A (Mar. 7, 1973) (payment by public utility to municipalities within its service area viewed as made to protect and promote business and therefore a business expense); cf. *The Citizens & Southern Bank of South Carolina*, 243 F. Supp. 900, 904 (W.D.N.Y. 1965) ("The provisions of the Code allowing charitable deductions do not prohibit corporations from deriving some benefit, direct or indirect, from charitable contributions. Indeed, it would seem to be requisite and proper that the corporation have some business purpose or derive some benefit from such contributions in order to justify them from a stockholder standpoint."). In some cases the Service has successfully challenged corporate contributions as purchases of goodwill, thus recharacterizing the contribution as a

B) The Foreign Tax Credit

In the case of multinational corporations, the charitable contribution deduction also intersects with rules governing the foreign tax credit. For multinational corporations not in an excess foreign tax credit position, the portion of a charitable contribution which must be allocated to foreign source income may reduce such credits and offset, in whole or in part, the benefits of the charitable contribution deduction.

In computing the foreign tax credit limitation, a taxpayer must distinguish between taxable income from U.S. sources and that from foreign sources. The more taxable income from foreign sources, the higher the tax credit limitation. A higher foreign tax credit results in a lower U.S. tax liability. To compute foreign and U.S. taxable income, U.S. income tax deductions must be allocated among gross income from the various sources. The greater the portion allocated to U.S. income, the lower the U.S. source taxable income and, correspondingly, the greater the foreign source taxable income. Thus, U.S. corporations prefer to allocate charitable deductions to U.S. income.

Deductions which are not definitely related to any gross income are apportioned to foreign source gross income in the same proportion that such income bears to worldwide gross income.¹⁴⁷ Present Treasury regulations treat the charitable deduction as not definitely related to any gross income.¹⁴⁸ The Treasury announced its decision to re-examine this treatment in 1989,¹⁴⁹ presumably prompted by the enactment of section 864(e) in 1986.¹⁵⁰ At the time, the Treasury

nondeductible capital expenditure. See *Transamerica Corp. v. United States*, 254 F. Supp. 504, 514-15 (N.D. Cal. 1966), *aff'd*, 392 F.2d 522 (9th Cir. 1968).

For a more complete survey of the treatment of the distinction by the Service and the courts, see Ronald L. Groves & Carolyn M. Osteen, 290-2nd T.M., *Charitable Contributions by Corporations*, A-20-25.

¹⁴⁷ Treas. Reg. § 1.861-8(c)(3).

¹⁴⁸ Treas. Reg. § 1.861-8(e)(9)(iv).

¹⁴⁹ Notice 89-91, 1989-2 C.B. 408.

¹⁵⁰ Section 864(e) was added to the Code by the Tax Reform Act of 1986, Pub. L. No. 99-514, § 1215 (a), 100 Stat. 2085, 2544 (1986). Section 864(e)(7) authorizes the Secretary of the Treasury to prescribe regulations to carry out the purposes of the section, including

merely clarified that the general rule of 864(e) – that expenses which are not directly allocable or apportioned to any specific income-producing activity shall be allocated and apportioned as if all members of an affiliated group were of a single corporation – would apply to charitable contributions, which are not considered directly allocable to any specific income-producing activity. Then, in early 1991, the Treasury proposed new regulations to deal with allocation of the deduction between foreign and U.S. source income.¹⁵¹ The proposed regulations provide that a contribution may be allocated entirely to U.S. source income only if three requirements are met: (1) the taxpayer designates the contribution for use solely within the U.S., (2) the taxpayer reasonably believes it will be so used, and (3) the contribution is not allocable to foreign source income under the following rule. The deduction is allocable to foreign source income for purposes of this provision if the taxpayer knows or has reason to know that the contribution will be used solely outside the U.S. or may necessarily be used only outside the U.S. A contribution that does not fit under the rules above is ratably apportioned according to Treasury Regulation 1.861-8(c)(3).

The proposed regulation provoked a public outcry from international charities.¹⁵² These charities feared that the new regulations increased the marginal benefit of giving to U.S. charities and would thus reduce corporate funding of international charities.¹⁵³

regulations providing for the apportionment of expenses allocated to foreign source income among the various categories of income.

¹⁵¹ Prop. Treas. Reg. § 1.861-8(e).

¹⁵² Charities which perform work abroad are referred to as "international charities." Charities which only perform work in the U.S. are referred to as "U.S. charities." However, it must be remembered that in order for a contribution to be deductible, the donee must be formed under U.S. laws. Exceptions to this rule are found in certain bilateral treaties. See *infra* text accompanying notes 230 - 288.

¹⁵³ See, e.g., Allocation of Charitable Contributions. Hearings on Proposed Regulations (INTL-116-90, 56 FR 10395) Before the Internal Revenue Service (Aug. 1, 1991) (statements by Bruce R. Hopkins on behalf of Outreach (USA) and Victoria B. Bjorklund, Counsel, and Chantal Firino, Executive Director, Doctors Without Borders USA); *Charity and the Tax Code*, Wash. Post, July 21, 1991, at C6; *Numerous Witnesses to Oppose Proposed Charitable Contributions Allocation Rule*, BNA DAILY REPORT FOR EXECUTIVES, Aug. 1, 1991, at G-5 (Taxation, Budget and Accounting); *Senators Appeal to Brady for Change in Charitable*

However, for multinational donors who make contributions solely for use in the United States, the proposed regulations would be an improvement over the current regulations. Currently, a corporation with foreign source income must use a portion of the charitable deduction to offset foreign income, thus reducing the foreign tax credit and the benefit of the deduction, even if the contribution is used solely in the United States. Since 95% of corporate charitable contributions are used solely in the United States, the majority of corporate multinationals would benefit from a rule which allowed such deductions to fully offset United States source income.¹⁵⁴

When the President's tax proposals for the 1993 budget went to markup by the House Committee on Ways and Means, they contained a provision which provided that, for purposes of computing the foreign tax credit, all charitable contribution deductions would be allocable to U.S. source income.¹⁵⁵ The Committee report presented the provision to the House but did not make any recommendations on the bill.¹⁵⁶ The estimated budget effect of the provision was a revenue loss of \$100 million in 1993 and an aggregate revenue loss of \$900 million over five years.¹⁵⁷ On July 2, 1992, Senators Moynihan, Danforth, and Boren also introduced a bill to amend the Code in this manner.¹⁵⁸ To finance this and other changes, the Senate bill proposed to establish new

Allocation Regulations, BNA INT'L BUS. DAILY, July 29, 1991; John Turro, *Death and Taxes: International Charities Cry Foul Over IRS Sourcing Rule*, 3 TAX NOTES INT'L 951 (1991); John Turro, *International Charities Attack Proposed Sourcing Rules*, 52 TAX NOTES 627 (1991). *But see Treasury Defends Charitable Allocation, Apportionment Rules*, BNA DAILY REP. FOR EXECUTIVES, July 29, 1991, at G-2 (Taxation, Budget and Accounting).

¹⁵⁴ See Edie, *supra* note 139.

¹⁵⁵ STAFF OF JOINT COMM. ON TAXATION, 102D CONG., 2D SESS., DESCRIPTION OF THE PRESIDENT'S TAX PROPOSALS INCLUDED IN THE FISCAL YEAR 1993 BUDGET AND AS INTRODUCED IN H.R. 4210, at 48 (Comm. Print 1992).

¹⁵⁶ H.R. REP. NO. 432, 102d Cong., 2d Sess., at 55 (1992).

¹⁵⁷ *Id.* at 70.

¹⁵⁸ S. REP. NO. 2979, 102d Cong., 2d Sess., at 3 (1992).

substantiation and disclosure requirements for contributions over \$100 and for all "quid pro quo" contributions.¹⁵⁹

Under the proposal adopted by the Senate Finance Committee, taxpayers would apportion 55% of their charitable contribution deductions to gross income from U.S. sources, and the remaining 45% of such deductions would be apportioned ratably between U.S. source and foreign source gross income, as under present law.¹⁶⁰ This method was estimated to lead to a revenue loss of \$27 million in 1993 and an aggregate revenue loss of \$370 million over five years.¹⁶¹

Despite all of the legislative activity on this issue, there was no mention of the provision in the final version of the legislation, which was vetoed by President Bush for unrelated reasons in November 1992. Similarly, the budget legislation for fiscal year 1993 signed by President Clinton did not address this issue.

In addition to its effect on international charities, the proposed regulations would also have a significant adverse effect on specific forms of corporate giving such as debt-for-nature swaps.¹⁶² In a debt-for-nature swap, a conservation organization acquires the debt of a foreign country and then exchanges the debt for the debtor's local currency. The conservation organization then contributes the currency to a conservation group or governmental unit within the debtor country for

¹⁵⁹ *Id.* The bill also proposed altering the tax treatment of gifts of appreciated property and repealing the \$150 million cap on the amount of tax-exempt bonds that private colleges are allowed to issue. *Id.*

¹⁶⁰ STAFF OF THE JOINT COMM. ON TAXATION, 102D CONG., 2D SESS., DESCRIPTION OF CHAIRMAN'S MARK TO H.R. 11 (REVENUE ACT OF 1992) 93 (Comm. Print 1992).

¹⁶¹ STAFF OF JOINT COMM. ON TAXATION, 102D CONG., 2D SESS., ESTIMATED REVENUE EFFECTS OF THE CHAIRMAN'S MARK 3 (Comm. Print 1992). This proposal, and not the one offered by Senators Moynihan, Danforth and Boren, was adopted because of its smaller impact on the fisc.

¹⁶² See Sherrille D. Bailey, *Charitable Deductions for Donations of Qualified Debt - The Need for Legislation*, 20 STETSON L. REV. 105, 106-07 (1990); Jolie F. Zimmerman, *The Tax Consequences of Debt for Nature Swaps: Foreign Tax Credit Limitations and the Need for Clarification*, 45 TAX LAW. 1083, 1085-86 (1992).

environmental programs.¹⁶³ There are many benefits of such a swap, and originally the United States promoted such swaps through favorable tax incentives and other legislation.¹⁶⁴ Benefits include increased conservation in the debtor country, a reduction in total debt of the debtor country, and the ability of the conservation group, through the heavily discounted nature of the debt, to increase the impact of its investment.

The debt may be acquired by the conservation group either by purchase on the secondary market or through a donation by the corporate holder to the conservation group. Because charitable deductions are limited to the fair market value of donated property, a donation of debt with a market value below its cost basis will prevent the donor from recovering its entire cost basis. If the debt is sold to the charity at a discount, the seller will be entitled to deduct only the loss on the sale.¹⁶⁵ In Revenue Ruling 87-124,¹⁶⁶ the Service ruled that a donor of such debt (whose fair market value is only a fraction of its face value) is entitled to a loss deduction for the difference between the fair market value and the taxpayer's adjusted basis.¹⁶⁷ The donor also receives a charitable deduction for the amount of the fair market value.¹⁶⁸

¹⁶³ These swaps are no longer used only for conservation purposes, but have been suggested for education and development initiatives. See, e.g., Eve Burton, *Debt for Development: A New Opportunity for Nonprofits, Commercial Banks, and Developing States*, 31 HARV. INT'L L.J. 233 (1990); Jennifer F. Zaiser, *Swapping Debt for Education: Harvard and Ecuador Provide a Model for Relief*, 12 B.C. THIRD WORLD L.J. 157 (1992).

¹⁶⁴ Zimmerman, *supra* note 163, at 1083, 1097.

¹⁶⁵ Ronny Jay Halperin, *Revenue Ruling 87-124: Treasury's Flawed Interpretation of Debt-for-Nature Swaps*, 43 MIAMI L. REV. 721, 723-24 (1989).

¹⁶⁶ 1987-2 C.B. 205.

¹⁶⁷ The Service has stated that fair market value is a question of fact and will be determined from all the facts of a specific case. See Eugene Gibson & Randall Curtis, *A Debt-for-Nature Blueprint*, 28 COLUM. J. TRANSNAT'L L. 331, 376 (1990).

¹⁶⁸ Many commentators have pointed out problems with this ruling. See, e.g., Bailey, *supra* note 163 (Revenue Ruling 87-124 is not binding on courts; the ruling may lead to

This ruling has never been codified in the Code or otherwise ratified by Congress. In construing the ruling, Eugene Steuerle, then Deputy Assistant Treasury Secretary for Tax Analysis, stated that a U.S. charity could work with a foreign organization without jeopardizing the deductible status of the donation so long as the U.S. charity had sufficient control and discretion to ensure that the contributions would carry out the U.S. charity's function and purpose.¹⁶⁹ However, the mere fact that a U.S. charity has sufficient "control and discretion" does not ensure that the funds will not be solely allocable to foreign source income under the proposed allocation regulations. Under the proposed regulations, any donation that the donor knows will be used in a foreign country is allocable to foreign source income.¹⁷⁰

The proposed regulations also may affect corporate contributions of foreign blocked income. Certain foreign countries have currency controls which limit the ability of multinational corporations to take the profits earned in that country and remit them back to the home country of the multinational, thus creating "foreign blocked income".

inconsistent results under substantially similar facts; the ruling is ineffective to trigger contributions of foreign debt to charities). Given the facts of the ruling:

Holders are more likely to sell the debt, recognize a loss, and contribute the proceeds of the sale for a charitable deduction than they are to contribute the debt directly for a charitable deduction only. While the former does not satisfy all the goals of the [conservation] organization, it is this transaction to which the IRS will liken donations of debt used to transact qualified debt swaps.

Id. at 116-17.

¹⁶⁹ Letter from Eugene Steuerle, Treasury Deputy Assistant Secretary for Tax Analysis, to Sen. John H. Chafee (Mar. 29, 1988), reprinted in 39 TAX NOTES 402 (1989); cf. Halperin, *supra* note 166, at 734-35 (arguing that foreign administration of conservation programs does not further the purposes of U.S. charities and that attempts by charities to force compliance with control requirements would be an affront to the national sovereignty of developing countries).

¹⁷⁰ The regulations state that a contribution to a worldwide wildlife conservation group, with a stipulation that the contribution be used solely outside the U.S. is allocable solely to foreign source income. Prop. Treas. Reg. § 1.861-8(i) Ex. 34 (1991). In a debt-for-nature swap, the donor may not always stipulate that the donation be used in the foreign country, but it certainly will know that the donation will be so used. *But cf.* Zimmerman, *supra* note 163, at 1098-99 & n.111 (questioning whether funds used by a U.S. charity to purchase debt, which is then swapped to a foreign organization, are used in the U.S.).

The income of a foreign corporation that either is a controlled foreign corporation¹⁷¹ ("CFC") but does not trigger Subpart F¹⁷² or is not a CFC is not included in the gross income of U.S. shareholders until it is actually distributed. Revenue Ruling 74-351¹⁷³ and Regulation section 1.964-2(b) allow U.S. taxpayers to defer recognition of blocked income of a foreign branch or the currently taxable income of a CFC until a triggering event occurs. Currently, taxpayers with foreign blocked income can benefit from making properly structured charitable contributions of such income.¹⁷⁴ If a foreign subsidiary were to pay a dividend of foreign blocked income to a bank account maintained in the foreign country by the U.S. parent, the parent could contribute the income and claim a charitable deduction. The U.S. parent would be required to include this dividend in income and then would be permitted to take a charitable deduction. Because charitable deductions currently are apportioned on the basis of the relative amounts of gross income from both domestic and foreign sources, a U.S. corporation with a high amount of U.S. source income relative to foreign source income will allocate only a small fraction of the gift to foreign source income, providing a higher foreign tax credit limitation than would otherwise result. If the proposed allocation regulation is enacted, corporations would be unable to take advantage of this tax benefit. All donations that must necessarily be used in a foreign country will be solely allocable to foreign income.¹⁷⁵ Thus, foreign income will be reduced by the entire gift (rather than only by a small fraction of it), the numerator of the foreign tax credit limitation fraction will be much smaller, and the available foreign tax credits may be under-utilized. Of course, if the U.S. corporation is

¹⁷¹ IRC. § 957.

¹⁷² IRC. § 951 et seq.

¹⁷³ 1974-2 C.B. 144.

¹⁷⁴ The following discussion is based on Sheldon Weinberg, *Charitable Contributions of Foreign Blocked Income*, 15 TAX ADVISER 418 (1984).

¹⁷⁵ The regulations offer the following example. A corporation donates blocked currency to a regional relief organization. The contribution will be allocable solely to foreign income because the corporation has reason to know it will necessarily be used outside the United States. Prop. Treas. Reg. § 1.861-8(i) Ex. 34 (1991).

already in an excess-credit posture – which is quite common in the current environment where U.S. corporate tax rates are typically lower than foreign corporate tax rates – this will have no fiscal impact.

C) Conclusion

The place-of-use restriction, which applies only to corporate donations to unincorporated donees, seems to fulfill no rational purpose. Does the use of corporate charitable donations abroad by unincorporated donees (as opposed to those made by incorporated donees) pose some specific danger? The answer provided by Congress seems to be no, given that there is no place-of-use restriction on individual donations, which comprise a much greater percentage of total giving. Perhaps the only explanation for the current state of the law is that the Service has allowed a loophole in the Code to be used to facilitate international use of donated funds, regardless of whether the donor is a corporation or an individual. Since there does not seem to be a logical reason to distinguish between incorporated and unincorporated donees or between incorporated and unincorporated donors, Congress should eliminate the place-of-use restriction on corporate donations to unincorporated donees. Finally, although the proposed allocation regulations raise a host of interesting issues, no action has been taken on these regulations to date. It does not appear that the Service could implement these regulations without raising a great deal of controversy.

V) Charitable Giving by Public Charities and Private Foundations

As discussed above, Code section 170 generally allows tax deductions for individuals and corporations which donate funds to organizations which are listed under Code section 170(c) as organizations eligible to receive tax deductible contributions.¹⁷⁶ These listed organizations may then make grants for specific projects or to other organizations, provided that the grants are used by the recipient for

¹⁷⁶ See *supra* parts II and IV.

either a specified purpose or for the exempt purpose for which the grantor public charity or private foundation is "organized and operated."¹⁷⁷

Because public charities and private foundations generally are not required to pay federal income taxes, they, unlike individual and corporate donors, are not concerned with obtaining a tax deduction.¹⁷⁸ Public charities and private foundations are most concerned about protecting their tax-exempt status and avoiding the imposition of excise taxes. Therefore, the grantor public charity or private foundation must ensure that any grants given, whether to domestic or foreign organizations,¹⁷⁹ are in furtherance of its charitable purpose. An exempt organization "organized and operated" to promote education, for example, may give grants to a school, which, in turn, will use the funds to further its educational purpose. There are, however, slightly different restrictions on international giving by public and private exempt organizations. The following section will describe the differences between requirements for international giving by public charities and private foundations.

A) International Giving by Public Charities

As provided in Code section 509(a), any domestic or foreign charitable organization is classified as a private foundation unless it falls into one of four other categories of organizations.¹⁸⁰ These four exceptions define the organizations considered "public charities." Sections 509(a)(1), (2), and (3) include those organizations that are, in various ways, subject to public control or function as support

¹⁷⁷ See *supra* note 10

¹⁷⁸ Both public charities and private foundations are, however, subject to unrelated business income taxes on income from certain unrelated trades or businesses. See I.R.C. §§ 511-14.

¹⁷⁹ See *infra* text accompanying note 185.

¹⁸⁰ I.R.C. § 509(a).

organizations to publicly supported charities.¹⁸¹ The fourth category includes organizations organized and operated exclusively for testing of public safety.¹⁸²

As a result of being subject to a requisite degree of public control, public charities are believed to be more accountable to the public and therefore are subject to fewer restrictions than private foundations.¹⁸³

¹⁸¹ Treas. Reg. § 1509(a)-1. Organizations included in these three categories are termed "public" charities, "publicly supported" charities, and "supporting" organizations. "Public" charities include churches, educational organizations, medical care and research organizations, and governmental units. They are defined in I.R.C. §§ 509(a)(1) and 170(b)(1)(A)(i)-(v). "Publicly supported" charities, defined in § 509(a)(2) and § 170(b)(1)(A)(vi), receive their primary support from the public. Finally, the category of "supporting" organizations is defined in § 509(a)(3) and includes organizations that are not themselves publicly supported but are closely related to public organizations which have the requisite degree of public control and involvement. See BRUCE R. HOPKINS, *THE LAW OF TAX-EXEMPT ORGANIZATIONS*, § 17 (1992). For an example of a religious organization which did not qualify as a church and was thus considered a private foundation, see *First Church of In Theo v. Commissioner*, 56 T.C.M. 1045 (1989).

¹⁸² I.R.C. § 509(a)(4). Contributions to organizations which test for public safety are not tax-deductible. Therefore, public safety organizations are more similar to business leagues or to social welfare groups than to private foundations. HOPKINS, *supra* note 182 at 241.

¹⁸³ Because of the perception that public charities are generally more accountable than private foundations, there are currently no intermediate sanctions for public charities, as there are for private foundations. However, there is a possibility that additional restrictions for public charities may be imposed, as there has been some discussion on the matter in hearings by the Oversight Committee of the House Ways and Means Committee. These restrictions seek to address problems including: the involvement of public charities in activities which constitute inurement and private benefit, such as excessive compensation; lack of intermediate sanctions resulting in punishment, such as revocation of exempt status, disproportionate to violations committed; and inefficacy of punishment often directed at the organization rather than at the individuals who commit the violation.

Suggested restrictions for public charities include caps on compensation for their executive officers, increased public disclosure, e.g. requiring the filing of Form 990 (Return of Organizations Exempt from Income Tax), and requirements for reapplication for exemption. See Robert A. Boisture & Milton Cerny, *Pickle Holds Hearings on Operations of Public Charities*, 60 TAX NOTES 225 (1993); Robert A. Boisture & Milton Cerny, *Second Oversight Subcommittee Hearing Explores Need for Intermediate Sanctions and More Disclosure*, 60 TAX NOTES 1387 (1993). If additional sanctions are imposed for public charities, they most likely will not be as rigid as the requirements for private foundations for three reasons. First, as mentioned above, there is not as much perceived abuse among public charities as among private foundations. Second, public charities are subject to greater public accountability, due to their board composition and

However, in order to protect their exempt status, public charities must exercise sufficient "discretion and control" to insure that funds given to grantee organizations are used for charitable purposes.¹⁸⁴ As set forth in section 501(c)(3), public charities, like private foundations, run the risk of losing their exempt status if they cannot demonstrate that they are operated primarily for charitable purposes.¹⁸⁵ Using funds or making grants for noncharitable purposes is one way a public charity may violate the operational test.¹⁸⁶

The safest way for a public charity to make grants without jeopardizing its tax-exempt status is to make grants to section 501(c)(3) organizations because these organizations have been deemed by the Service to be organized and operated exclusively for charitable purposes.¹⁸⁷ However, a grantor public charity will not jeopardize its exempt status by distributing funds to nonexempt organizations if the grantor charity retains sufficient discretion and control to ensure that the funds are used for exempt purposes.¹⁸⁸

If the public charity retains sufficient discretion and control, it may also give grants that will be used abroad. Revenue Ruling 63-252¹⁸⁹

dependence on public support. Finally, public charities are heavily dependent on support from their board members, often of the sort that would be barred under the self-dealing rules currently applicable to private foundations.

¹⁸⁴ This restriction really means that there is no conduit involved in individual giving to public charities because the charity must retain sufficient control and discretion over the funds in order to keep within its charitable purpose. In other words, if the public charity has retained sufficient control and discretion it is not a "mere conduit," and individuals contributing to it should receive their charitable deduction even if the charity, in turn, makes grants to foreign organizations. See *supra* text accompanying notes 51-83.

¹⁸⁵ See 1992 EOCPE, *supra* note 51, at 222-23.

¹⁸⁶ See discussion of the "organized and operated exclusively for" test, *supra* note 10.

¹⁸⁷ As indicated by Treas. Reg. § 1501(c)(3)-1(c)(1), an organization will be regarded as 'operated exclusively' for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in Section 501(c)(3).

¹⁸⁸ Rev. Rul. 68-489, 1968-2 C.B. 210.

¹⁸⁹ 1963-2 C.B. 101. See also *infra* notes 50-91 and accompanying text, discussing earmarking and conduit restrictions on individual taxpayers.

holds that contributions to a domestic public charity are deductible even if some or all of its funds are then transmitted to a foreign charitable organization. The domestic charity must show that the gift is, in fact, to or for the use of the domestic organization, and that the domestic organization is not serving as an agent for, or the conduit of, a foreign charitable organization.¹⁹⁰ The Service amplified this ruling in Revenue Ruling 66-79,¹⁹¹ which concludes that a contribution to a domestic charity is deductible even when solicited for a specific project of a foreign charitable organization, provided that the domestic charity (1) reviews and approves the specific grant as being in furtherance of its charitable purposes and (2) has full discretion and control over the use of the funds.¹⁹²

Accordingly, public charities will not jeopardize their exempt status by making grants either to organizations which have been granted exempt status by the Service¹⁹³ or to nonexempt organizations, as long as the public charity retains sufficient discretion and control over the use of its funds. Because few foreign organizations have filed for recognition by the Service,¹⁹⁴ in most situations, public charities must

¹⁹⁰ *Id.* See *supra* note 52.

¹⁹¹ See *supra* note 59 and accompanying text.

¹⁹² *Id.* See also Gen. Couns. Mem. 35319 (Apr. 27, 1973) for an example of insufficient discretion and control. Because the "Fund" discussed in this memorandum did not review and approve specific projects for which its funds would be used before making a grant to a noncharitable foreign organization, the Service found that it had not exercised sufficient discretion and control. Although the Service does not require that the grantor organization know the identities of the ultimate recipients of the funds, the grantor must "clearly show by other means that its control responsibilities will be met without its having advance identification of the ultimate foreign distributees." *Id.* at 4. In making such a showing, the grantor charitable organization might (1) apprise the foreign organization of the limitations imposed on it under § 170(c) and make clear to its agents that they are subject to these limitations; (2) review the proposed projects and approve those calculated to accomplish its qualified charitable objectives before turning over any funds for expenditure; (3) turn over its funds only as needed for specific projects; or (4) make periodic audits of programs and require periodic financial statements by its agents. *Id.* at 13.

¹⁹³ Rev. Rul. 68-489, *supra* note 189.

¹⁹⁴ See *infra* note 200.

retain sufficient discretion and control over the use of grants made to a foreign organization.

B) International Giving by Private Foundations

The general rule for giving by private foundations is that the grant must be made for a charitable purpose.¹⁹⁵ A foundation may satisfy this requirement in one of two ways. First, the private foundation may give grants to an organization which is a public charity as defined in section 509(a)(1), (2), or (3), or an exempt operating foundation as defined in section 4940(d)(2).¹⁹⁶ Included in these categories are public charities organized in the U.S. but performing activities and services in other countries, such as "friends of" organizations organized for the purpose of assisting foreign organizations;¹⁹⁷ foreign governments, or any instrumentality or agency thereof, or an international organization designated by Executive Order under Title 22 of U.S. Code section 288, if the grant is made for exclusively charitable purposes and not for governmental ones;¹⁹⁸ and entities created outside the U.S. that have filed Form 1023 with the Service to obtain recognition as a public charity.¹⁹⁹

¹⁹⁵ I.R.C. §§ 4942(g)(1)(A), 4945(d). Revenue Ruling 71-460 specifically holds that an activity which is charitable within the meaning of § 501(c)(3), if carried on in the United States, would also be a charitable activity if carried on in a foreign country. Rev. Rul. 71-460, 1971-2 C.B. 231. See *supra* text accompanying note 10.

¹⁹⁶ I.R.C. § 4945(d)(4). See also Edie, *supra* note 139, at 24.

¹⁹⁷ See *supra* text accompanying notes 76-83.

¹⁹⁸ Treas. Reg. § 53.4945-5(a)(4)(iii); 1992 EOCPE, *supra* note 51, at 242. See Gen. Couns. Mem. 35,485 (Jun. 13, 1973).

¹⁹⁹ Creation on foreign soil is not a bar to exemption from taxation under I.R.C. § 501(c)(3). Rev. Rul. 66-177, 1966-1 C.B. 132. See Dale, *supra* note 33, at 685-94 for a discussion of the treatment of foreign charities and foundations. However, because it is an expensive and time-consuming process, few foreign organizations have filed for I.R.S. recognition. With certain exceptions, most tax exempt organizations other than private foundations must file Form 990 (Return of Organizations Exempt from Income Tax). I.R.C. § 6033(a)(1); see I.R.S. Publication 557, Chap. 2 (Rev. Jan. 1992).

However, there is evidence that the Service is making an effort to relieve foreign organizations of unnecessary filing burdens. To relieve foreign organizations

Second, if the private foundation wishes to make a grant to an organization that does not meet the above requirements, the grantor foundation must exercise "expenditure responsibility." This option requires that the grantor foundation be responsible for exerting all reasonable efforts (1) to see that the grant is spent solely for the purpose for which it was made, (2) to obtain full and complete reports from the grantee on how the funds are spent, and (3) to make full and detailed reports with respect to such expenditures to the Service.²⁰⁰

However, Treasury regulations²⁰¹ allow the grantor private foundation to make an equivalency determination: the private foundation may determine that the foreign grantee is an equivalent of a public charity as defined in section 509(a)(1), (2), or (3) of the Code.²⁰² The "general mechanism"²⁰³ for meeting the requirements of the regulations²⁰⁴ is a two-step process that includes: (1) making a

from this burden, the Service has issued Revenue Procedure 94-17, which exempts certain foreign organizations from filing Form 990. To qualify for this exemption, the foreign organization must meet two conditions. First, it must not normally receive more than \$25,000 in gross receipts annually from sources in the United States. See Rev. Proc. 83-23, 1983-1 C.B. 687. Second, the foreign organization must have "no significant activity" in the United States. "Significant activity" includes lobbying and political activity and the operation of a trade or business but does not include investment activity. Revenue Procedure 94-17 applies for tax years beginning after December 31, 1992. Rev. Proc. 94-17, 1994-5 IR.B. 24.

²⁰⁰ I.R.C. § 4945(h). See Priv. Ltr. Rul. 9223054 (Mar. 12, 1992) which allowed a private foundation to make a grant to a newspaper when it exercised expenditure responsibility. "[T]he fact that the newspapers may not themselves qualify as charities as such, does not detract from the charitable character of X's program [T]he newspaper . . . is merely the instrument by which X seeks to accomplish its charitable purposes." See also Priv. Ltr. Rul. 9306034 (Nov. 20, 1992).

²⁰¹ Treas. Reg. § 53.4945-5(a)(5).

²⁰² "Such an affidavit or opinion must set forth sufficient facts concerning the operations and support of the grantee for the Internal Revenue Service to determine that the grantee would be likely to qualify as an organization described in section 509(a)(1), (2), or (3)." *Id.*

²⁰³ Rev. Proc. 92-94, § 4.06, 1992-2 C.B. 508.

²⁰⁴ Treas. Reg. §§ 53.4945-6(c)(2)(ii), 53.4942(a)-3(a)(6), 53.4945-5(a)(5).

"reasonable judgment"²⁰⁵ that the grantee is an organization described in section 501(c)(3) (other than one that is also described in section 509(a)(4)), and (2) making a "good faith determination,"²⁰⁶ based on the 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).²⁰⁷ The legal opinion must have sufficient facts concerning operation and support of the grantee for the Service to determine that the grantee would qualify.²⁰⁸

²⁰⁵ Treas. Reg. § 53.4945-6(c)(2)(ii).

²⁰⁶ Treas. Reg. §§ 53.4942(a)-3(a)(6), 53.4945-5(a)(5).

²⁰⁷ Rev. Proc. 92-94, § 204, 1992-2 C.B. 507.

²⁰⁸ Requiring the procurement of a legal opinion is far from a formalistic requirement; there are many restrictions which govern the practice of lawyers. Lawyers who violate a jurisdiction's standards of ethical and professional conduct will be subject to the disciplinary rules of that jurisdiction. Misconduct by lawyers may lead to public sanctions, such as disbarment, suspension, probation, reprimand, or private sanctions, which include admonition, restitution to injured parties, and limitation on the lawyer's nature or extent of practice. LAW. MAN. ON PROF. CONDUCT (ABA/BNA) §§ 01607, 101101, 301 (July 28, 1993); GEOFFREY C. HAZARD, JR. AND W. WILLIAM HODES, *THE LAW OF LAWYERING: A HANDBOOK ON THE MODEL RULES OF PROFESSIONAL CONDUCT* §§ 8.1, 8.4 (2d ed. 1993). Furthermore, Circular 230 (31 C.F.R. § 10), which articulates the rules and responsibilities governing tax lawyers' practice before the Service, requires "due diligence as to accuracy" in any matter governed by the Service. 31 C.F.R. § 10.22. Noncompliance with the rules and regulations set forth in Circular 230 may lead to disbarment or suspension from practice before the Service. 31 C.F.R. § 10.50. There is no reference to the issuance of non-tax shelter tax opinions in Circular 230. However, in tax shelter opinions, "the practitioner must provide an opinion whether it is more likely than not that an investor will prevail on the merits of each material tax issue . . . which involves a reasonable possibility of a challenge by the Internal Revenue Service." 31 C.F.R. § 10.33. See generally BERNARD WOLFMAN & JAMES P. HOLDEN, *ETHICAL PROBLEMS IN FEDERAL TAX PRACTICE* (2d ed. 1985); Theodore C. Falk, *Tax Ethics, Legal Ethics, and Real Ethics: A Critique of ABA Formal Opinion 85-352* (1986); Gwen Thayer Handelman, *Law and Order Comes to "Dodge City": Treasury's New Return Preparer and IRS Practice Standards*, 50 WASH. & LEE L. REV. 631 (1993); Barbara T. Kaplan, *Annual Report: Important Developments During the Year: Standards of Tax Practice*, 42 TAX LAW. 1493 (1989); J. Timothy Philipps, *It's Not Easy Being Easy: Advising Tax Return Positions*, 50 WASH. & LEE L. REV. 589 (1993); Paul J. Sax et al., *A.B.A. Special Task Force Report on Formal Opinion 85-352*, 39 TAX LAW. 365 (1986); Paul J. Sax et al., *Formal Opinion 85-352*, 39 TAX LAW. 631 (1986).

Although this is a costly and time-consuming procedure,²⁰⁹ obtaining a legal opinion from counsel protects the managers of the foundation from being personally subjected to penalty taxes. Because they will be deemed to have acted with "reasonable cause," they will not be penalized, as long as they did not "knowingly" or "willfully" violate Treasury regulations.²¹⁰

Revenue Procedure 92-94,²¹¹ which was made effective on January 1, 1993, provides a simplified procedure by which private foundations may avoid exercising expenditure responsibility. The Revenue Procedure allows the grantor foundation to base its "reasonable judgment" and "good faith determination" on a "currently qualified" affidavit prepared by the grantee²¹² as long as it fulfills the affidavit requirements outlined in Revenue Procedure 92-94.²¹³ Requirements include a statement as to how the foreign organization was created, a copy of its organizational documents, a statement of its activities, and representations that the foreign country's "laws and customs" preclude private benefit and prohibited inurement.²¹⁴ The Revenue Procedure prescribes the form the affidavit must take; certain variations are permitted.²¹⁵

Revenue Procedure 92-94 is a safe harbor provision. As indicated, it is not the only procedure by which private foundations can make

²⁰⁹ See Michael I. Sanders, *Support and Conduct of Charitable Operations Abroad*, 1 NOTRE DAME INST. ON CHARIT. GIVING, FOUNDATIONS, AND TRUSTS 33, 42-45 (1976), for a discussion of the difficulties of this procedure.

²¹⁰ I.R.C. § 4945(a)(2); Treas. Reg. § 4945-1(a)(2)(vi).

²¹¹ 1992-2 C.B. 508.

²¹² The grantee organization is "currently qualified" as long as the facts its affidavit contains are "up to date," and the grantor has no reason to doubt the validity of the affidavit. Rev. Proc. 92-94, §§ 4.02-4.05. A grantee's attested statement that the affidavit is up to date is sufficient to update an affidavit. *Id.* at § 4.04.

²¹³ *Id.* at §§ 5.1-5.13.

²¹⁴ Mark B. Weinberg & Peter C. Wolk, *IRS "Simplifies" Procedures for Private Foundation Grants to Foreign Entities*, 52 J. TAX'N OF EXEMPT ORGS. 59 (1993).

²¹⁵ Rev. Proc. 92-94, § 5.04, 1992-2 C.B. 508.

grants to foreign organizations.²¹⁶ However, use of the affidavit facilitates the process of international grantmaking for both the grantor and the grantee. First, because the affidavit is not specific to a grantor foundation, it can be used by a particular grantee for an unlimited number of grantors.²¹⁷ Furthermore, the grantee organization need only file a "currently qualified" affidavit once, updating it when necessary. In addition, because there is no need for the grantor to obtain a legal opinion for an organization which has a "currently qualified" affidavit on file,²¹⁸ Revenue Procedure 92-94 helps to reduce aggregate legal fees for the grantor. By facilitating transactions between private foundations and international donees, the benefits of Revenue Procedure 92-94 appear to outweigh the costs or risks associated with the possibility that grantees may file inaccurate affidavits.

C) Special Restrictions on Private Foundations

Private foundations exempt under Code section 501(c)(3) are subject to the same rules as public charities regarding the requirement they be organized and operated exclusively for charitable purposes.²¹⁹ However, private foundations face additional restrictions because unlike public charities, private foundations were believed by Congress to be less accountable to the public.

Perceptions of elitism, irresponsible governance, and inadequate response to public needs have plagued private foundations.²²⁰ While

²¹⁶ See *supra* text accompanying note 201.

²¹⁷ The grantor may base its "reasonable judgment" and "good faith determination" on a "currently qualified" affidavit prepared by the grantee *for the grantor or another grantor . . .*" Rev. Proc. 92-94, § 4.01, 1992-2 C.B. 508 (emphasis added). Before Rev. Proc. 92-94, a private foundation could not merely rely on the good faith determination of another private foundation, even as to the same grantee.

²¹⁸ Rev. Proc. 92-94, § 4.01, 1992-2 C.B. 508.

²¹⁹ See *supra* note 10.

²²⁰ See F. EMERSON ANDREWS, PHILANTHROPIC FOUNDATIONS (1956); HOPKINS, *supra* note 182, at 355, 362; STERN, THE GREAT TREASURY RAID 242-246 (1964); WORMSER, FOUNDATIONS: THEIR POWER AND INFLUENCE (1958); Branch, *The Case Against Foundations*, WASH. MONTHLY 3 (1971).

Chairman of the Senate Subcommittee on Foundations, former Senator Vance Hartke expressed a commonly held sentiment when he stated, "There are many examples of private foundations in this country which do an excellent job, but they are outnumbered at least five to one by foundations which are failing to serve the public purpose adequately."²²¹

Extensive provisions restricting the activities of private foundations were included in the Tax Reform Act of 1969 to address these concerns and ensure public accountability of private foundations.²²² These provisions impose intermediate sanctions and penalties on both the private foundation and its principal officers. Private foundations may be subject to section 4942 penalties for "failure to distribute income."²²³ In addition, a private foundation must not engage in any acts of self-dealing with individuals deemed to have a measure of direct or indirect control over the organization or a particular relationship with the organization or with persons in control of the organization.²²⁴ A private foundation also must not retain excess business holdings,²²⁵ make investments which jeopardize its charitable purpose,²²⁶ or make taxable expenditures.²²⁷ Taxable expenditures

²²¹ 121 Cong. Rec. S3035 (1975) (speech of Sen. Hartke, *Foundations at the Crossroads*).

²²² See Special Rules for Existing Foundations, I.R.C. § 508(e)(2).

²²³ I.R.C. § 4942. Private foundations are required to make annual "qualifying distributions," which include amounts "paid to accomplish one or more purposes described in section 170 (c)(2)(B)," but generally exclude amounts paid to a non-operating foundation. This requires a private foundation making a grant to a foreign charity to determine whether the foreign charity is a non-operating foundation.

²²⁴ I.R.C. § 4941(d).

²²⁵ I.R.C. § 4943(c).

²²⁶ I.R.C. § 4944. Program-related investments ("PRIs"), however, are exempt from this restriction. As defined in § 4944(c) and Treas. Reg. § 53.4944-3, PRIs are investments made with the primary purpose of accomplishing one or more of the purposes described in § 170(c)(2)(B) and not for the purpose of producing income or appreciating property. Because PRIs involve making use of assets at below-market rates, they are less similar to investments and more like gifts to the grantee organization. As such, they are not considered investments which jeopardize the organization's charitable purpose.

include making grants to organizations which are not defined in section 509(a)(1), (2), (3) or section 4940(d)(2), unless the private foundation exercises expenditure responsibility.²²⁸ If a private foundation engages in any of these prohibited acts, it will not only be subject to intermediate sanctions and penalties, but also may lose its exempt status, regardless of whether the grantee is a domestic or foreign organization. Following the requirements of Revenue Procedure 92-94 will protect a private foundation making grants to a foreign organization from the imposition of excise taxes under both sections 4942 and 4945.²²⁹

D) Conclusion

In furthering their charitable purposes, public charities and private foundations are subject to different grantmaking restrictions. As long as public charities exercise sufficient control and discretion to ensure that their funds are being used in furtherance of their charitable purposes, public charities are generally free to make grants for charitable purposes to both domestic and international organizations.

Private foundations, on the other hand, are subject to more stringent restrictions on their activities, and recipients of foundation grants must be exempt organizations or their equivalents. If Revenue Procedure 92-94 fulfills its intended purpose, the process of "equivalency determination" will make domestic and international grantmaking by private foundations no more difficult than that by public charities.

VI) Deductibility by Treaty

In an exception to the general rule prohibiting tax deductions to individuals for direct contributions to foreign charities, such deductions

²²⁷ I.R.C. § 4945(d).

²²⁸ I.R.C. § 4945(h). *See supra* text accompanying notes 196-209.

²²⁹ Rev. Proc. 92-94, § 1, 1992-2 C.B. 507. *See supra* text accompanying notes 211-218. *See also* Dale, *supra* note 33, at 680-683, for an in-depth discussion of this issue.

are allowed under certain bilateral tax treaties.²³⁰ The Treasury Department has not included a charitable deduction provision in its Model Income Tax Treaty.²³¹ However, the U.S. has in effect treaties which contain such provisions with Canada, Mexico, and Israel.²³² In addition, the U.S. has ratified estate and gift tax treaties which contain provisions for charitable deductions as well.²³³

A) Income Tax Treaties²³⁴

1. Canada Treaty

The Canadian treaty states that:

For the purposes of United States taxation, contributions by a citizen or resident of the United States to an organization which is resident in Canada, which is generally exempt from Canadian tax and which could qualify in the United States to receive

²³⁰ I.R.C. § 894(a)(1) states that "[i]n general - the provisions of this title shall be applied to any taxpayer with due regard to any treaty obligation of the United States which applies to such taxpayer." However, I.R.C. § 7852(d)(1) states that "[i]n general - For the purpose of determining the relationship between a provision of a treaty and any law of the United States affecting revenue, neither the treaty nor the law shall have preferential status by reason of its being a treaty or law." Prior to amendment by Pub. L. No. 100-647, § 1012(aa)(1)(A), this section read, "No provision of this title shall apply in any case where its application would be contrary to any treaty obligation of the United States in effect on the date of enactment of this title." Thus, it seems that treaty provisions are no longer automatically preferred to Code provisions.

²³¹ Treasury Department's Model Income Tax Treaty of June 16, 1981, *reprinted in* 1 Tax Treaty (CCH) ¶ 10,573 (1990).

²³² An income tax treaty was in force between the United States and Honduras; however, it expired on December 31, 1966. An income tax treaty between the United States and Japan that contained an exempt organization provision expired on July 9, 1972.

²³³ *See infra* text accompanying notes 275-287.

²³⁴ This section of the Article will only discuss those income tax treaties which affect the donor's ability to receive a charitable deduction and will not discuss treaties which affect the exempt status of the donee.

deductible contributions if it were resident in the United States, shall be treated as charitable contributions.²³⁵

The treaty imposes section 170(a) percentage limitations on contributions to Canadian organizations, but it bases the limits on Canadian source income.²³⁶ Thus, if a U.S. taxpayer derives income in Canada and then contributes to a Canadian organization that meets U.S. requirements for exempt organizations, the taxpayer may take a deduction but only of up to 50% of his or her Canadian source income (or 30% in the case of 170(b)(1)(B) organizations). The treaty allows deductions only for contributions to organizations which could qualify for exempt status in the United States, thus requiring an assessment of equivalence in every case.²³⁷

Congress has expressed concern that the Canada Treaty would nonetheless allow deductions for contributions to charities which, if they were U.S. entities, would not qualify for a deduction in the United States. The Committee on Foreign Relations appeared to fear that the Executive Branch, through its treaty powers, would impinge on the Legislative Branch's taxation powers. The Report by the Committee on Foreign Relations stated that:

[T]he Committee remains deeply concerned about the granting of deductions to U.S. persons by treaty where the Code does not otherwise grant the deductions In most cases, the objectives of special treaty deductions provisions can be accomplished through domestic law. The Committee does not believe that

²³⁵ Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital, Aug. 16, 1984, U.S.-Can, art. XXI, para. 5, T.I.A.S. No. 11,087 ["Canada Treaty"]. A 1995 Protocol to the Canada Treaty also extends the charitable deduction to include contributions to "a Canadian company that is taxable in the United States as if it were a resident of the United States." Proposed Protocol Amending the 1980 Tax Convention with Canada, Mar. 17, 1995, U.S.-Can, 1 Tax Treaty (CCH) ¶ 21,043-7 ["Proposed Canada Protocol"]. The Proposed Canada Protocol was signed by President Clinton on April 24, 1995, but has not been ratified.

²³⁶ *Id.*, art. XXI, para. 5. The treaty also creates an exception for donations to a college or university at which the U.S. citizen or resident, or a family member of such person, is enrolled. The Code's percentage limitations on U.S. contributions are described *supra* text accompanying note 13.

²³⁷ Rev. Proc. 59-31, 1959-2 C.B. 949.

treaties are a proper forum for providing deductions not otherwise permitted under domestic law.²³⁸

Thus, Congress was wary that the Executive Branch might "trump" the Code with treaties which would circumvent the Code's restrictions on deductions for contributions to foreign organizations. The Committee on Foreign Relations added that "the Committee will, in the future, seriously consider recommending a reservation on any treaty provision that grants U.S. persons deductions not otherwise allowed under the Code."²³⁹

This concern led the Senate to make a reservation to a similar provision in the U.S.-Brazil Income Tax Treaty.²⁴⁰ The Brazil Treaty would have allowed an American citizen to receive a deduction for contributions to Brazilian charities if the recipient organization qualified as a charitable organization under Code section 501(c)(3).²⁴¹ In its report on the treaty, the Senate Foreign Relations Committee noted that:

The only other United States tax treaty now in force which contains a similar provision is with Canada, and the Committee does not believe that the practice of allowing tax deductions to Americans for contributions to organizations in foreign countries should be expanded by the tax treaty process This is particularly true when one considers that the American taxpayer would be subsidizing such charitable contributions Moreover in the Committee's view, there is no justification for supporting charities organized abroad until positive steps have

²³⁸ Tax Convention (and Proposed Protocols) with Canada, S. EXEC. REP. NO. 98-92, 98th Cong., 2d Sess., at 9 (1984).

²³⁹ *Id.*

²⁴⁰ Convention Between the Government of the United States of America and the Government of the United States of Brazil for the Avoidance of Double Taxation with Respect to Taxes on Income, Mar. 13, 1967, U.S.-Braz., *reprinted in* 1 Tax Treaty (CCH) ¶ 19,001 (1992) (not yet in effect) ["Brazil Treaty"].

²⁴¹ *Id.* at art. 22.

been taken to correct the abuses found in some of our domestic tax-exempt foundations.²⁴²

As will be seen below, such concerns did not bar deductions in the U.S.'s treaty with Mexico. However, the Committee stressed that because the United States shares borders with Canada and Mexico, it may have a stronger desire to enhance charitable activity in these countries. In addition, concerns over the North America Free Trade Agreement also may have affected the response to the treaty.

2) Mexico Treaty

The Convention between the United States and Mexico has been signed and ratified. The Mexico Treaty is similar to the Canada Treaty, but contains some differences as well.²⁴³ It differs from the Canada Treaty in that it provides reciprocal recognition of charities resident in either country. Article 22 states that:

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 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.²⁴⁴

²⁴² Report of the Senate Foreign Relations Committee on the Convention Between the United States and Brazil for the Avoidance of Double Taxation with Respect to Taxes on Income, Signed on Mar. 13, 1967, S. EXEC. REP. NO. 5, 90th Cong., 2d Sess., at 3 (1968).

²⁴³ Convention and Protocol 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, S. TREATY DOC. No. 7, 103rd Cong., 2d Sess (1992) ["Mexico Treaty"].

²⁴⁴ *Id.*, art. 22, para. 2.

Thus, the Mexico Treaty provides that the U.S. will recognize organizations found to qualify as charities under Mexican law if Mexico passes equivalent laws to those governing the qualification of U.S. charitable organizations. If such laws are passed, Mexican organizations need not prove themselves equivalent to U.S. public charities; rather they are deemed to be equivalent, provided that they attain charitable status under Mexican law.

In fact, Mexico did pass laws which adopted U.S. statutory standards for public charities.²⁴⁵ The Protocol to the Convention states that Article 70-B of the Mexican Income Tax Law provides "essentially equivalent" standards to those in U.S. law.²⁴⁶ The Convention states that:

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.²⁴⁷

In an earlier draft of the Mexico Treaty, this language was interpreted to apply only to organizations which met the formal requirements for being a "section 501(c)(3) charity."²⁴⁸ However, the summary of the proposed treaty provision specified that the organization must qualify under section 509(a) as *not* being a "private foundation."²⁴⁹ Thus, this provision does appear to be more strict than the Canadian provision, because it allows deductions only for contributions to public charities.²⁵⁰

²⁴⁵ But see *infra* text accompanying notes 251-253 regarding United States public policy restrictions on charitable organizations, which are not explicitly included in the Mexico Treaty.

²⁴⁶ Mexico Treaty, *supra* note 243, First Protocol, Point 17, para. b.

²⁴⁷ *Id.*, art. 22, para. 2.

²⁴⁸ Thomas A. Troyer, *Caplin & Drysdale Submits Draft Treaty Proposal on Charitable Contributions*, 5 EXEMPT ORG. TAX. REV. 1115 (1992).

²⁴⁹ *Id.* See also Bjorklund, *supra* note 27.

²⁵⁰ The Summary of Proposal for Provisions on Philanthropy in Mexico-United States Tax Treaty also states that "Mexican private foundations deriving substantially all their support from non-U.S. sources would be exempted from the special U.S. tax rules

The Canada Treaty, in contrast, allows deductions for contributions to any Canadian organization which is equivalent to a U.S. charitable organization under Code section 501(c)(3).

On the other hand, the Mexico Treaty could provide much more leeway for charitable deductions than does the Canada Treaty. For although Mexico's Article 70-B now reads similarly to section 509(a)(1) and (2), it is not clear that Mexico must adopt the United States's interpretation of the Code. Thus, U.S. cases and Revenue Rulings seem not to play a role in Mexico's assessment of its organizations' qualification for Article 70-B status. For example, the restrictions developed under *Bob Jones University v. United States*,²⁵¹ which deny exempt status to educational institutions that discriminate based on race, may not apply to Mexican organizations.²⁵² This, in turn, could permit a racially discriminatory Mexican university to receive tax deductible contributions from U.S. residents. Such deductions might not be available if the university were in the United States.

Neither the Convention nor the Protocol addresses this issue explicitly. However, the Protocol does include a provision which states,

if the competent authority of the other Contracting State determines that granting such benefits is inappropriate with respect to a particular organization or type of organization, such benefits may be denied after consultation with the competent authority of the first Contracting State.²⁵³

governing U.S. private foundations." See *supra* note 248. See also Milton Cerny, *International Philanthropy: Cross-Border Grant Making and the U.S.-Mexico Tax Treaty*, 94 *TNI* 196-17 (Oct. 11, 1994).

²⁵¹ *Bob Jones Univ. v. United States*, 461 U.S. 574 (1983) (disallowing income tax deductions for contributions to a private university which discriminated based on race).

²⁵² See also Cerny, *supra* note 250 (stating that, "[c]ompetent authority in the implementing protocol to the U.S.-Mexico treaty provides that . . . article 70-B of the Mexican Income Tax Law and the public charity provisions of section 509(a)(1) or (2) of the U.S. IRC, as interpreted by the governing regulations and administrative rulings of Mexico and the United States, provide essentially equivalent standards . . .").

²⁵³ Mexico Treaty First Protocol, *supra* note 243, point 17, para. (b)(ii). 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).

Thus, it appears that on a case-by-case basis, the United States could deny exempt status to particular organizations which violate United States fundamental public policy, even if the organizations meet the standards codified in sections 509(a) and (b).²⁵⁴ Such a denial could be issued only if granting exempt status were found to be "inappropriate."²⁵⁵ However, the Protocol provides no guidelines for what may be considered "inappropriate." The Protocol's vagueness makes it extremely difficult to ascertain exactly how and when this provision could be used, or if it could be used to enforce such United States public policy interests as non-discrimination or integration.

Like the Canada Treaty, the Convention with Mexico applies section 170(b) percentage limitations to Mexican source income in restricting the amount of charitable contributions which may be deducted.²⁵⁶ However, the Convention also appears to allow limitations other than percentage limitations on the amount contributed.²⁵⁷ The Convention states that:

contributions . . . 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.²⁵⁸

The parallel provision in the U.S.-Canada Treaty states that:

such contributions . . . shall not be deductible in any taxable year to the extent that they exceed an amount determined by applying the *percentage limitations* of the laws of the United

²⁵⁴ *Id.*

²⁵⁵ *Id.*

²⁵⁶ Mexico Treaty, *supra* note 243, art. 22, para. 2

²⁵⁷ Bjorklund, *supra* note 27, at 13.

²⁵⁸ Mexico Treaty, *supra* note 243, art. 22, para. 2

States²⁵⁹

A draft version of the U.S.-Mexico Treaty included the words "percentage limitations" where it now says only "limitations."²⁶⁰ This deletion could imply that additional limitations are applicable, such as the related-use restrictions in Code section 170(e).²⁶¹

Aside from these differences, the two treaties are essentially the same. The intent behind the treaty provisions for exempt organizations appears to have been to facilitate charitable giving to foreign organizations. Thus, as described by the U.S. Treasury Department, the Mexico Treaty was intended:

to encourage contributions by U.S. residents to small Mexican charities that would have difficulty in organizing a U.S. entity through which contributions could be directed, or in satisfying the administrative requirements for recognition as a foreign corporation eligible for treatment as a "public charity" in the United States.²⁶²

In addition, as the United States shares borders with Canada and Mexico, U.S. citizens living near the borders may work directly with Canadian and Mexican charitable organizations. Thus, the Treasury Department explained that:

Article 22 also enables taxpayers living and operating at the border to support organizations across the border from which they derive benefits. The physical proximity of Mexico and the United States provides a unique circumstance for the reciprocal

²⁵⁹ Canada Treaty, *supra* note 235, art. XXI, para. 5.

²⁶⁰ Troyer, *supra* note 248.

²⁶¹ IRC § 170(e)(1)(B). On the other hand, this discrepancy may have resulted from careless drafting and may not actually signify that other restrictions apply to charitable contributions under the Mexico Treaty.

²⁶² TREAS. DEPT. TECH. EXPLANATION OF THE CONVENTION AND PROTOCOL 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 at 42.

recognition of tax-exempt organizations.²⁶³

Clearly, despite the Foreign Relations Committee's concern over using the treaty process to provide deductions not otherwise permitted under domestic law,²⁶⁴ both the Canadian and Mexican treaties circumvent the domestic recipient requirement which the Code imposes on all other charitable contributions made to foreign organizations. The fact that Congress did not object to the Mexico Treaty provision, as it did to the Brazilian provision, could signal a change in Congress's approach to the charitable deduction.²⁶⁵ However, the special relationships that the United States has with its neighbors may have created a special need for such provisions that the U.S. does not have with other countries. Thus, it seems unlikely that this type of treaty provision will become the norm.²⁶⁶

In addition, the fact that the treaties restrict deductions according to foreign source income diminishes their impact on individual donors, who generally do not have a great deal of foreign source income.²⁶⁷ In contrast, the provisions could have a greater impact on corporations with foreign subsidiaries or branches than on individuals, since they have larger and more regular foreign source incomes. It is thus difficult to gauge how U.S. charitable giving would be affected by the treaties.

²⁶³ *Id.*

²⁶⁴ See *supra* text accompanying note 238.

²⁶⁵ See Philip D. Morrison, *U.S.-Mexico Tax Treaty Breaks New Ground - Implications for the New U.S. Model and for Latin America*, 5 TAX NOTES INT'L 825 (1992). See also Zack D. Mason, *Foreign Charitable Contribution Deductions: A Shift in U.S. Tax Treaty Policy?*, 7 EXEMPT ORG. TAX REV. 624 (1993). *But cf.* Dale, *supra* note 33.

²⁶⁶ But see discussion of treaty with Israel, *infra* text accompanying notes 268-272; Cerny, *supra* note 250 (arguing that it is possible that as more foreign countries look to replicate the U.S. charitable sector, "there is an emerging set of principles based on a common concept of charity and establishment of rules for administrating charities . . . that are equivalent to the administration of charities in the United States," which may make it easier for the United States to establish the same equivalency of charitable principles it established with Mexico, and thereby develop similar treaty provisions).

²⁶⁷ An exception would be U.S. resident aliens, who may have a great deal of foreign source income.

3) Israel

The 1975 U.S.-Israel Income Tax Treaty²⁶⁸ was ratified and took effect on January 1, 1995. The Israel Treaty provides a reciprocal deduction for charitable contributions. Article 15A of the 1980 Protocol to the treaty allows United States residents to deduct contributions to Israeli charitable organizations "if and to the extent that they would have been treated as charitable contributions had such organization been created or organized under the laws of the United States."²⁶⁹ Thus, like the treaty with Canada, the treaty with Israel requires a determination that an Israeli organization would in fact qualify for exemption under United States standards before a U.S. donor may deduct his or her contribution.

Like the Mexico Treaty, however, the U.S. and Israel may determine that their qualification procedures are substantially similar. In that case, each Contracting State confers exempt status on organizations which qualify for such status under the other Contracting State's laws. A note was exchanged at the signing of the protocol stating that the competent authorities will review the procedures of the other country to make this determination.

Unlike the Canada and Mexico treaties, where U.S. percentage limitations on the charitable deduction apply, the Israel Treaty fixes the percentage limitation at 25%.²⁷⁰ However, like the other two treaties, the Israel Treaty bases this calculation on income from sources within Israel only.

As it did with the Canada treaty, the Senate Foreign Relations Committee expressed concern over granting deductions to U.S. persons

²⁶⁸ Convention with Respect to Taxes on Income, Nov. 20, 1975, U.S.-Isr., S. EXEC. C. NO. 2, 94th Cong. 2d Sess. (1975); Second Protocol, Jan. 26, 1993, TREATY DOC. No. 103-16, 140 CONG. REC. S13,276 (daily ed. Sept. 22, 1994) ["Israel Treaty"].

²⁶⁹ *Id.* Article 15A(1) is reprinted in full in Milton Cerny, *U.S./Israel Tax Treaty*, 10 EXEMPT ORG. TAX REV. 1156, 1157. See generally Samuel M. Krieger & David Martin, *Health Care Tax Developments: The Recognition of Charitable Deductions Under the Proposed Israel-U.S. Tax Treaty*, 8 EXEMPT ORG. TAX REV. 1007 (1993).

²⁷⁰ Article 15A(1).

by treaty in cases where the Congress has chosen not to do so under the Code.²⁷¹ However, the Committee noted that it was:

aware that a similar provision is contained in the Canadian treaty and that this provision was negotiated with that precedent in mind. Accordingly, because of the importance of this provision to Israel the Committee will not recommend a reservation. The Committee will, however, very seriously consider such a recommendation if in the future, a treaty with a similar provision is negotiated and is transmitted to the Senate.²⁷²

This statement again illustrates Congress's hesitance to approve treaty provisions which provide for the charitable deductions described here.^{273,274}

²⁷¹ REPORT OF THE SENATE FOREIGN RELATIONS COMMITTEE ON THE TAX CONVENTION (AND PROPOSED PROTOCOL) WITH ISRAEL, reprinted in 2 Tax Treaty (CCH) ¶ 32,560 (1994).

²⁷² *Id.*

²⁷³ Congress failed to ratify a proposed treaty with Thailand, which allowed individual donors a charitable deduction for contributions to Thai organizations which filed for and received exempt status under I.R.C. § 501(c)(3). Proposed Treaty Between Thailand and the United States, reprinted at 3 Tax Treaty (CCH) ¶ 42,514 (1990), art. 18. This appears to be the only example of a treaty provision which allowed U.S. donors to deduct contributions to foreign organizations which were registered in the U.S. as exempt under 501(c)(3). It is unclear whether similar provisions will be included in other treaties.

²⁷⁴ The United States had a treaty with Honduras which is no longer in force. The Treaty stated that:

[T]here shall be treated as a charitable contribution any contribution made by the taxpayer to a religious, charitable, scientific, literary or educational organization under the laws of the other State if (A) contributions to such organizations would qualify for deduction under the laws of the former State had such organization been created under the laws of such former State . . . and (B) contributions to such organizations would qualify for deductions under the laws of such other State.

A Convention between the United States and Honduras for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, June 25, 1956, U.S.-Hon., 1957-2, C.B. 1033, exp'd. Dec. 31, 1966. This provision was similar to the provision in the Canada Treaty. However, Revenue Procedure 59-31, 1959-2 C.B. 951, explained that Honduran charitable organizations must obtain exempt status under Code

B) Estate and Gift Tax Treaties

The United States has also ratified several estate and gift tax treaties. Some of these treaties contain provisions regarding charitable gift deductions. Currently, the U.S. has such treaties in effect with France, Germany, Denmark, and Sweden. They parallel the Treasury Department's 1980 Model Estate and Gift Tax Treaty, but differ in certain respects.

The Model Treaty stated that:

3. The transfer or deemed transfer of property to or for the use of a corporation or organization of one Contracting State organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes shall be exempt from tax by the other Contracting State if and to the extent that such transfer:

(a) is exempt from tax in the first-mentioned Contracting State; and (b) would be exempt from tax in the other Contracting State if it were made to a similar corporation or organization of that other State.²⁷⁵

The Model Treaty thus did not distinguish between U.S. citizens and residents and non-resident aliens. In this respect it differed from the Code provisions which govern the charitable deduction for non-resident aliens under both the estate and gift taxes. Code section 2106(a)(2) allows non-resident aliens to deduct only charitable bequests to U.S. organizations.²⁷⁶ Code section 2522(b)(2) similarly restricts non-resident aliens, allowing a charitable deduction only for gifts to U.S. qualifying organizations.²⁷⁷ Under the Model Treaty, in contrast,

§ 501 (c)(3) before contributions to these organizations would be considered deductible. It does not appear that the Canada Treaty requires this procedure.

²⁷⁵ Treasury Department's Model Estate and Gift Tax Treaty of November 20, 1980 ("Model Treaty"), art. 8, para. 3, *reprinted in*, 1 Tax Treaty (CCH) ¶ 10,553 (1990). The U.S. recently withdrew the Model Treaty; a new one is expected to be issued shortly.

²⁷⁶ I.R.C. § 2106(a)(2).

²⁷⁷ I.R.C. § 2522(b). Treas. Reg. 25.2522(b)-1(2) also requires gifts to any trust, community chest, fund or foundation, or a fraternal society, order or association operating under the

nonresident aliens are permitted to deduct donations to foreign charities.²⁷⁸

Other than this difference, the Model Treaty did not appear to expand the Code's transfer tax provisions regarding charitable deductions. In fact, the Model Treaty did not specifically include the encouragement of art and amateur sports, or the prevention of cruelty to children or animals, as the estate and gift tax Code sections do.²⁷⁹ The Model Treaty thus did not augment the individual's ability to give or bequeath money to foreign charitable organizations.

The estate and gift tax treaties with Denmark²⁸⁰ and Sweden²⁸¹ include the same or similar language as the Model Treaty. However, the treaty with France includes an additional provision requiring that the organization "receive[] a substantial part of its support from contributions from the public or governmental funds."²⁸² The Senate Foreign Relations Committee explained that in computing the French tax this provision barred deductions for contributions to a private foundation, even if the contribution would be deductible under U.S. law.²⁸³ However, under the Code, U.S. donors may receive a deduction for contributions to French organizations which do not receive substantial public or governmental funds.

In addition, the French treaty specifies that transfers to a

lodge system to be used within the United States. The estate tax code provision also contains this restriction. I.R.C. § 2106(2)(A)(iii).

²⁷⁸ Treasury Department Technical Explanation of the United States Model Estate and Gift Tax Convention, Nov. 20, 1980, art. 8, *reprinted in* 1 Tax Treaty (CCH) ¶ 10,567 (1990).

²⁷⁹ I.R.C. §§ 2055(a), 2522(a).

²⁸⁰ Estate and Gift Tax Convention with the Kingdom of Denmark, May 24, 1984, U.S.-Den., art. 9, S. EXEC. REP. NO. 98-26, at 9.

²⁸¹ Estate and Gift Tax Convention with the Government of Sweden, May 21, 1984, U.S.-Swed., T.I.A.S. No. 10,826.

²⁸² Convention on Estate and Gift Tax Between France and the United States of America, Aug. 7, 1980, U.S.-Fr., art. 10, 32 U.S.T. 1935, T.I.A.S. No. 9812 ["French Treaty"].

²⁸³ REPORT OF THE SENATE FOREIGN RELATIONS COMMITTEE ON THE CONVENTION BETWEEN THE UNITED STATES AND FRANCE ON ESTATE AND GIFT TAXES SIGNED NOV. 24, 1978, *reprinted in* 2 Tax Treaty (CCH) ¶ 27,273 (1992).

Contracting State or a political or administrative subdivision thereof are not deductible unless specifically limited to a religious, charitable, scientific, literary or educational purpose.²⁸⁴ This parallels the U.S. requirement that gifts to foreign political subdivisions must be limited specifically to charitable purposes.

The United States-Germany treaty provision differs only in that it allows deductions for donations to organizations which have "religious, charitable, scientific, or *public* purposes, or to a *public body of a Contracting State to be used for such purposes*"²⁸⁵ This implies that the treaty with Germany allows donations to German political subdivisions more expansively than the Code allows. However, neither the Technical Explanation nor the Senate Foreign Relations Committee Report draws this distinction. It thus seems likely that the drafters intended this provision to signify what the Model Treaty signifies; the Senate Foreign Relations Committee Report noted that "A similar exemption is contained in the U.S. model treaty."²⁸⁶

Finally, the 1995 proposed Protocol to the Canada Treaty addresses estate tax deductions for charitable bequests.²⁸⁷ The Protocol provides that if the property of a resident of one Contracting State passes to an exempt organization in the other Contracting State, each State shall accord the same death tax treatment that it would have accorded if the the organization had been a resident of the first Contracting State.²⁸⁸ Thus, it too parallels the estate tax Code provisions and the Model Treaty, although it does not replicate either.

²⁸⁴ *Id.*, art. 10, para. 3.

²⁸⁵ Convention Between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation with Respect to Taxes on Estates, Inheritances, and Gifts, U.S.-Ger., June 27, 1986, T.I.A.S. No. 11,082 (emphasis added).

²⁸⁶ REPORT OF THE SENATE FOREIGN RELATIONS COMMITTEE ON THE ESTATE AND GIFT TAX TREATY WITH THE FEDERAL REPUBLIC OF GERMANY, *reprinted in* 2 Tax Treaty (CCH) ¶ 28,434 (1990).

²⁸⁷ Proposed Canada Protocol, art. 19, 1 Tax Treaty (CCH) ¶ 21,043.

²⁸⁸ *Id.*

C) Conclusion

The United States has income tax treaties in effect with some 60 countries. However, only the conventions discussed here, Canada, Mexico, and Israel, contain provisions regarding charitable deductions. The rest do not alter restrictions on cross-border charitable giving contained in the Code. The estate and gift tax treaties similarly follow the Code provisions. Thus, except for Canada, Mexico, and Israel, the estate and gift tax treaties reflect a policy which seems to give taxpayers an incentive to wait until after death to donate money to foreign charities, as does the Code itself.²⁸⁹

The income tax treaties raise a crucial issue: how should we determine whether a foreign charitable organization is in fact equivalent to a U.S. organization qualified under the Code? The Mexico treaty exemplifies one possible mechanism: require the foreign country to promulgate laws equivalent to the U.S. Code provisions which regulate exempt organizations. However, this method may not suffice to ensure that deductions are denied for contributions to foreign organizations which counter U.S. public policy considerations. Thus, perhaps a more stringent test must be created, requiring equivalent statutory provisions and also compliance with certain anti-discrimination provisions. On the other hand, such a requirement could be seen as an imposition of American values on other countries.

It is also difficult to forecast how these treaty provisions will actually influence charitable activity. All the income tax treaties impose percentage limitations based on foreign source income; since few individuals have substantial foreign source income, it seems unlikely that many will even qualify for the deduction.²⁹⁰ Thus, in order to create incentives for international gift-giving, perhaps these percentage limitations should be removed.

Finally, it is unclear whether Congress will continue to ratify treaties which counter the restrictions contained in the Code, as it did in the Mexico Treaty, or whether it will reserve regarding the charitable

²⁸⁹ See *supra* text accompanying note 103.

²⁹⁰ However, these treaties may provide significant incentives for U.S. corporations with foreign source income.

deduction provisions, as it did in the Brazil Treaty. One author has argued that such provisions appear to discriminate among the world's charities for political reasons, and that therefore either a world tax treaty or domestic legislation should be adopted that would uniformly recognize the deductibility of contributions to foreign charities.²⁹¹ Such a concern is valid: the treaties do allow U.S. citizens to receive a charitable deduction for donations to organizations in Canada, Mexico, and Israel only, and could create the appearance of favoring these countries over others. Thus, perhaps the United States should consider either expanding the opportunity for charitable deductions for donations to all organizations, regardless of country of origin, or contracting it, in order to treat all nations alike. On the other hand, given the current political climate, it seems unlikely that Congress will act in a way which would decrease the country's tax revenues. Given the unwillingness already expressed by Congress to allow charitable deductions by treaty, it seems unlikely that treaties with additional countries will include charitable deduction provisions like those discussed here.

VII) Non-tax Restrictions on Charitable Giving²⁹²

There are three non-tax statutory frameworks under which donations made to foreign recipients can be limited.²⁹³ One of these regimes, based on various sections of the Export Administration Act²⁹⁴ (EAA) and its Amendments, provides the framework for the general regulation of exports. The second regime consists of the "emergency

²⁹¹ See generally Milton Cerny, *U.S.-Israel Tax Treaty*, 10 EXEMPT ORG. TAX REV. 1156 (1994).

²⁹² See *infra* Appendix.

²⁹³ In addition to these regimes, there are other laws which restrict the sending of particular goods to foreign countries. See, e.g., the Atomic Energy Act, 42 U.S.C.A. §§ 2011-2296 (1991); the Nuclear Non-Proliferation Act, 22 U.S.C.A. §§ 3201-3282 (West 1991); and the Arms Export Control Act, 22 U.S.C.A. § 2751 (West 1994). Additionally, as the now repealed Comprehensive Anti-Apartheid Act of 1986, 22 U.S.C.A. §§ 5001-5117, (West 1990), demonstrates, restrictions can be imposed in regard to specific countries.

²⁹⁴ 50 U.S.C.A. App. §§ 2401-2420 (West 1991).

acts:²⁹⁵ the Trading with the Enemy Act²⁹⁵ (TWEA) and the International Emergency Economic Powers Act²⁹⁶ (IEEPA). Additionally, under the U.N. Participation Act of 1945,²⁹⁷ U.S. persons are subject to any U.N. mandates which restrict donations.

In general, the restrictive powers granted to the President under the emergency acts are more powerful than those found in the EAA²⁹⁸ and the powers under the U.N. act are broader than both the emergency acts and the EAA. Donations of money may not be regulated or prohibited by the EAA. Additionally, the EAA's ability to regulate or prohibit donations of articles is rather limited because goods designed to meet basic human needs can be donated anywhere as long as certain procedures are followed. The United Nations Participation Act permits the regulation or prohibition of any transactions - including the donation of money and goods - but only if mandated by the United Nations Security Council. The IEEPA permits the regulation or prohibition of donations of money to foreign recipients whenever a national emergency has been declared, but only allows donations of certain articles to be regulated or prohibited when additional determinations have been made by the President as to the threat such donations would pose to United States interests. Regulations under the IEEPA are currently in effect with respect to Angola, Haiti, Iran, Iraq, Libya, and the Federal Republic of Yugoslavia. The TWEA permits the regulation or prohibition of donations of both money and articles. However, the TWEA currently only applies to North Korea, Cambodia, and Cuba, and in the future may only be invoked in the event of a war.

²⁹⁵ 50 U.S.C.A. App. §§ 1-44 (West 1990).

²⁹⁶ 50 U.S.C.A. §§ 1701-06 (West 1991).

²⁹⁷ 22 U.S.C.A. § 287c (West 1990).

²⁹⁸ See Barry E. Carter, *International Economic Sanctions: Improving the Haphazard U.S. Legal Regime*, 75 CAL. L. REV. 1162, 1189 (1987).

VIII Conclusion

As discussed above, the Code provisions and the implementing regulations governing international charitable giving appear to be inconsistent in several ways:

- 1) Unless a treaty provision states to the contrary, individuals forego the charitable deduction if they contribute directly to foreign organizations. However, individuals may contribute to a domestic organization which uses the funds abroad. Thus, to receive the charitable deduction, individuals may contribute to a "friends of" organization, but not to the organization "befriended." Treaties augment this inconsistency by allowing individuals to receive a deduction for direct charitable activity in certain countries, which the Code would otherwise prohibit.
- 2) On the other hand, under the estate and gift tax regime, individuals may receive charitable deductions for direct contributions to foreign organizations. However, the estate and gift tax provisions are not consistent with each other in the deductions they allow.
- 3) Corporations may not contribute directly to a foreign charity, or even to a domestic trust, chest, fund, or foundation which uses the funds abroad. But a corporation may donate money to a domestic corporate charity which uses the funds abroad. In addition, treaties allow corporations to receive deductions for direct contributions to foreign charities.
- 4) Public charities may fund foreign charitable projects as long as the charities exercise sufficient control and discretion over the funds. Although private foundations also may fund foreign projects, and Revenue Procedure 92-94 facilitates the process they must satisfy more stringent charitable purpose requirements than public charities. Yet, it is far from clear that public charities are in fact more reliable than private foundations.

Given the confused statutory framework, compounded by an unclear legislative purpose, the regulations can be best understood as an attempt by the Service to develop a regulatory scheme that allows cross-border charitable giving as long as the gift is made for a charitable purpose. Thus, the regulations have some substantive effect, despite their many inconsistencies and their seemingly formalistic approach.

For example, the earmarking and conduit restrictions, which apply to individuals, corporations, and tax-exempt organizations, attempt to prevent the taxpayer from receiving a deduction for a donation to an organization which appears charitable in the tax return but in reality is not. Similarly, Revenue Procedure 92-94 creates a means by which foundations can determine that a foreign grantee has a charitable purpose. Finally, "friends of" organizations provide the Service with some limited assurance that the organization assisted is charitable by creating, to some extent, a U.S. administrative review of the ultimate recipient of the funds.

Improvements to the statute could only help the Service implement consistent and rational rules. Congress should recognize that the government burden theory does not adequately justify the current treatment of charitable contributions.²⁹⁹ It therefore should amend the statute with clear policies in mind, in order to avert the inadequacies of previous legislation. While Congress could choose to eliminate the deduction for foreign contributions altogether, such a decision appears shortsighted. Eliminating the deduction might create some additional revenues and would end the administrative burdens on the Service that the deduction creates. Since Americans currently appear to be focused on domestic problems in particular, this policy might not meet significant resistance, although the outcry over the foreign tax credit allocation regulations suggests otherwise.

On the other hand, the end of the Cold War, the development of communications technology, and the "globalization" of the economy all contribute to a more integrated international landscape. Americans now receive more information about international events than ever before and may be more involved with foreign affairs, personally or commercially. They may also develop a greater interest in charitable activity abroad. Furthermore, U.S. foreign policy involves tremendous amounts of financial aid to foreign countries. Helping taxpayers participate in this process benefits the United States as a whole, in both public perception and actual policy. Thus, it seems that the United States will benefit more from facilitating cross-border charitable giving than it will from discouraging it.

²⁹⁹ See Dale, *supra* note 33.

Congress should revise Code section 170(c)(2)(A) to eliminate the geographic restriction on giving, but still require some determination of the foreign donee's charitable status. The donor should not bear the burden of proof for this determination. Such a burden will surely deter charitable contributions. Congress could simply require foreign charities to qualify under Code section 501(c)(3) in order for contributions to them to be deductible. However, this places a great burden on the foreign organization. An independent nonprofit organization could be created specifically to facilitate the determination of the charitable status of foreign organizations. The organization could assist donors and donees with the process of assessing the foreign organization's status.

Congress should also revise the last paragraph of section 170(c)(2) to allow corporations to give to a trust, chest, fund, or foundation as well as to a corporation which uses the funds abroad. Revenue Procedure 92-94's guidelines should be extended to corporations, allowing them to donate directly to foreign organizations provided they obtain the appropriate affidavit and proof of status. Revenue Procedure 92-94 also could be extended to public charities, thereby avoiding confusion regarding the requirements necessary to satisfy the "sufficient discretion and control" test and creating greater uniformity in the regulations governing public charities and private foundations.

Congress should also revise the estate and gift tax provisions to make them consistent with each other. Congress must decide whether these provisions should conform to the scheme used by the income tax provisions. Finally, Congress should consider whether to apply the system of donee status determination to treaties as well, or whether the Mexico Treaty method of requiring equivalent laws will suffice to ensure a charitable donee.

If Congress does decide to make such changes to the Code, it should also consider prohibiting deductions for charitable gifts to organizations which violate fundamental U.S. public policies, such as organizations which discriminate based on race. It is unrealistic, and probably impossible, to ascertain every such violation. However, in the process of making Revenue Procedure 92-94's "good faith" determination of charitable status, perhaps a similar determination could be made on issues of discrimination. Of course, Congress must strike a balance between upholding U.S. public policy and imposing U.S. values and morals on other cultures.

If only for the sake of clarity and consistency in the law, the charitable deduction provisions of the Internal Revenue Code should be revised. Such improvements to the statute can only help the IRS implement Congressional policies in a more rational and consistent manner. As the world becomes increasingly "globalized," it is important to address larger questions of the role of charitable activity in international and domestic policy.

Appendix

D) The Emergency Acts

The International Emergency Economic Powers Act (IEEPA) was enacted in 1977 to correct what Congress saw as a major flaw in the Trading with the Enemy Act (TWEA): namely, that the President could invoke the provisions of the TWEA based on a declaration of a national emergency which was internal to the U.S. and could continue to exercise the TWEA powers until he terminated the declaration.³⁰⁰ These declarations were not terminated once made, causing the "TWEA emergency authority [to] operate[] as a one-way ratchet to enhance greatly the President's discretionary authority over foreign policy."³⁰¹ As a result, the IEEPA was adopted and the TWEA was amended so that subsequent declarations would apply only in a time of war.³⁰²

A) The International Emergency Economic Powers Act

The IEEPA is triggered when the President declares a national emergency with respect to a threat from outside the U.S.³⁰³ The

³⁰⁰ See *Emergency Controls on International Economic Transactions: Hearings Before the Subcomm. on International Economic Policy and Trade of the House Comm. on International Relations, 95th Cong., 1st Sess. (1977); and Revision of Trading with the Enemy Act, Markup Before the House Comm. on International Relations, 95th Cong., 1st Sess. (1977).*

³⁰¹ *Regan v. Wald*, 468 U.S. 222, 245 (1984) (Blackmun, J., dissenting). There were four declarations of national emergencies in effect at the time the TWEA was amended: President F. Roosevelt's 1933 Bank Holiday Declaration, Proclamation No. 2040, 48 Stat. 1691; President Truman's declaration warning against the threat of communist aggression, Proclamation No. 2914, 64 Stat. A454; President Nixon's 1970 declaration concerning a Post Office strike, Proclamation No. 3972, 3 C.F.R. 473; and President Nixon's 1971 declaration concerning the country's balance-of-payments problems, Proclamation No. 4074, 3 C.F.R. 60. President Truman's communism declaration was the one most often invoked. *Regan v. Wald*, 468 U.S. at 245-46.

³⁰² International Emergency Economic Powers Act, Pub. L. No. 95-223, § 101(a), 91 Stat. 1626 (codified at 50 U.S.C.A. § 1701 (1995)).

³⁰³ "Any authority granted to the President by section 1702 of this title may be exercised to deal with any unusual and extraordinary threat, which has its source in whole or

President is required to report to Congress every six months regarding the status of any emergency under which the authorities of the IEEPA are invoked.³⁰⁴ Additionally, the national emergency must be continued by the President each year or it will automatically terminate,³⁰⁵ although the President may still be able to exercise some of the authorities granted by the IEEPA despite the termination.³⁰⁶ Currently, emergencies exist under the IEEPA with respect to the proliferation of chemical and biological weapons,³⁰⁷ and with respect to the following countries: Angola,³⁰⁸ the Federal Republic of Yugoslavia (Serbia and Montenegro),³⁰⁹ Iran,³¹⁰ Libya,³¹¹ and Iraq.³¹² The national

substantial part outside the United States, to the national security, foreign policy, or economy of the United States, if the President declares a national emergency with respect to such threat." 50 U.S.C.A. § 1701(a) (West 1991).

³⁰⁴ 50 U.S.C.A. § 1703(c) (West 1991).

³⁰⁵ Within 90 days prior to the anniversary date of the declaration of an emergency, the President must publish a notice in the Federal Register stating that such emergency is to continue. National Emergencies Act, 50 U.S.C.A. § 1622(d) (West 1991).

³⁰⁶ 50 U.S.C.A. § 1706(a) (West 1991).

³⁰⁷ The emergency was initially declared on November 16, 1990, in Exec. Order No. 12,735. The notice extending the emergency beyond November 16, 1993 was published by President Clinton on November 12, 1993. 58 Fed. Reg. 60,361. This emergency was most recently extended on November 16, 1994. 59 Fed. Reg. 59,099 (1994). Under the National Emergency Act, declarations of national emergencies are valid for one year from the date of declaration, unless terminated before then or extended again within 90 days of that date. 50 U.S.C.A. § 1622(d) (West 1991).

A similar national emergency was declared by President Clinton on September 30, 1993. Exec. Order No. 12,868, 58 Fed. Reg. 51,749 (1993) in regard to the "proliferation of nuclear, biological and chemical weapons and the means of delivering such weapons." The national emergency was declared under both the IEEPA and the EAA; the declaration gives the Secretary of Commerce the authority to issue regulations.

³⁰⁸ The emergency was declared in Exec. Order No. 12,865, 58 Fed. Reg. 51,005 (Sept. 26, 1993). The declaration only prohibits the sale or supply of arms and related material, military vehicles and petroleum products to UNITA or to territory of Angola other than through points of entry designated by the Secretary of the Treasury. *Id.*

³⁰⁹ The emergency was declared in Exec. Order No. 12,808, 57 Fed. Reg. 23,299 (1992) and was expanded in Exec. Order No. 12,810, 57 Fed. Reg. 24,347 (1992), Exec. Order No. 12,831, 58 Fed. Reg. 25,253 (1993), Exec. Order No. 12,846, 58 Fed. Reg. 25,771 (1993), and extended by notice on May 26, 1993, 58 Fed. Reg. 30,693 (1993) and on October 25, 1994, 59 Fed. Reg.

emergency declared with respect to Haiti in 1991 was terminated by executive order on October 14, 1994.³¹³

Once triggered, the IEEPA gives the President the authority to:

[I]nvestigate, regulate, direct and compel, nullify, void, prevent or prohibit, any acquisition, holding, withholding, use, transfer, withdrawal, transportation, importation or exportation of, or dealing in, or exercising any right, power, or privilege with respect to, or transactions involving, any property in which any foreign country or a national thereof has any interest, by any person, or with respect to any property, subject to the jurisdiction of the United States.³¹⁴

54,177 (1994). In December 1995, certain sanctions were suspended as part of the U.S. - brokered peace agreement reached by the presidents of the Federal Republic of Yugoslavia (Serbia & Montenegro), the Republic of Bosnia, and the Republic of Croatia. However, Executive Orders 12,808 and 12,934 remain in effect. Pres. Determination No. 96-7, 60 Fed. Reg. 2,887 (1995). In January 1996, OFAC authorized prospectively all transactions previously prohibited with respect to the Federal Republic of Yugoslavia (Serbia & Montenegro), although assets previously blocked remain blocked. 61 Fed. Reg. 1,282 (1996).

³¹⁰ The emergency was declared in Exec. Order No. 12,170, 44 Fed. Reg. 65,729 (1979) and was extended by notice on November 2, 1993, 58 Fed. Reg. 58,639 (1993). Additional extensions were declared on March 15, 1995 in Exec. Order No. 12,957, 60 Fed. Reg. 14,615 (1995) and on May 6, 1995 in Exec. Order No. 12,959, 60 Fed. Reg. 24,757 (1995).

³¹¹ The emergency was declared in Exec. Order No. 12,543, 51 Fed. Reg. 875 (1986) and was extended by notice on December 2, 1993, 58 Fed. Reg. 64,361 (1993), again on May 6, 1995, 60 Fed. Reg. 24,757 (1995), and most recently on May 15, 1995, 60 Fed. Reg. 14,615 (1995).

³¹² The emergency was declared in Exec. Order No. 12,722, 55 Fed. Reg. 31,803 (1990), was extended by notice on July 21, 1993, 58 Fed. Reg. 39,111 (1993), again on August 23, 1994 in Exec. Order No. 12,924, 59 Fed. Reg. 43,437 (1994), and most recently on August 15, 1995, 60 Fed. Reg. 42,767 (1995).

³¹³ The emergency was revoked in Exec. Order No. 12,932, 59 Fed. Reg. 52,403 (1994). The emergency was originally declared in Exec. Order No. 12,775, 56 Fed. Reg. 50,641 (1991). Additional orders were given, blocking certain properties, in Exec. Order No. 12,853, 58 Fed. Reg. 35,843 (June 30, 1993) and Exec. Order No. 12,872, 58 Fed. Reg. 54,029 (Oct. 18, 1993). The emergency was also extended by notice on September 30, 1993, 3 C.F.R. § 377 (1993).

³¹⁴ 50 U.S.C.A. § 1702(a)(1)(B) (West 1991). The TWEA contains identical language. 50 U.S.C.A. App. § 5(b)(1)(B) (West 1990).

The Department of the Treasury's Office of Foreign Assets Control (OFAC) promulgates rules under the IEEPA.

Based on the fear that while "[m]onetary contributions may be intended to serve humanitarian purposes . . . the person making the contribution has no control over the end use of the funds,"³¹⁵ all monetary contributions may be prohibited. However, authority under the IEEPA is limited with regard to the donation of articles which are intended to relieve human suffering. Under the IEEPA, in order to restrict the donation of these articles, the President must make additional determinations as to the threat such donations would pose to the U.S.³¹⁶ To date, no such determinations have been made.

This exception is only as broad as the definition of "articles intended to relieve human suffering." No explicit definition is given in the statute, although the legislative history provides that donated articles should be presumed to be intended to relieve human suffering "when that is the stated intention of the donor and when the articles might reasonably be expected to serve that end."³¹⁷

Thus, unless the President makes the required additional determinations, donations of articles which the donor intends to relieve human suffering and which can reasonably be expected to do so cannot

³¹⁵ S. REP. NO. 95-466, 95th Cong., 1st Sess. 5 (1977) *reprinted in* 1977 U.S.C.C.A.N. 4540, 4544.

³¹⁶ Section 1702(b) states:

The authority granted to the President by this section does not include the authority to regulate or prohibit, directly or indirectly . . . (2) donations, by persons subject to the jurisdiction of the United States, of articles, such as food, clothing, and medicine, intended to be used to relieve human suffering, except to the extent that the President determines that such donations (A) would seriously impair his ability to deal with any national emergency declared under section 1701 of this title, (B) are in response to coercion against the proposed recipient or donor, or (C) would endanger Armed Forces of the United States which are engaged in hostilities or are in a situation where imminent involvement in hostilities is clearly indicated by the circumstances . . . 50 U.S.C.A. § 1702(b) (West 1991).

³¹⁷ S. REP. NO. 95-466, 95th Cong., 1st Sess. 5 (1977), *reprinted in* 1977 U.S.C.C.A.N. 4540, 4544.

be regulated or prohibited under the IEEPA. The only relevant case on this subject agrees:

The meaning of section 1702(b)(2), when illuminated by its legislative history, is clear. The President has no authority to regulate or prohibit, directly or indirectly, donations by persons subject to the jurisdiction of the United States of articles, as distinguished from funds, which the donor intends to be used to relieve human suffering if the articles can reasonably be expected to serve that purpose.³¹⁸

Furthermore, the court in that case found that OFAC could not issue regulations restricting donations or requiring prior licenses in order to make such donations, unless the additional determinations had been made by the President.³¹⁹ The court implied that the vehicles that the plaintiffs intended to donate to the people of Nicaragua were likely to be valid donations intended to relieve human suffering, unless they could not reasonably be expected to achieve that purpose.³²⁰

In general, the regulations issued under the IEEPA specifically exempt donations intended to relieve human suffering. The Haitian regulations provide:

Except as otherwise authorized, no goods, technology . . . or services may be exported from the United States, either directly or indirectly, to Haiti, except (a) publications and other informational materials, (b) donations of articles intended to relieve human suffering, such as food, clothing, medicine and medical supplies, and (c) rice, beans, sugar, wheat flour, and cooking oil.³²¹

³¹⁸ *Veterans Peace Convoy, Inc. v. Schultz*, 722 F. Supp. 1425, 1432 (S.D. Tex. 1988).

³¹⁹ *Id.* at 1430-31.

³²⁰ *Id.* at 1432. The court did not specifically rule as to whether the vehicles qualified as donations to relieve human suffering since most of the original convoy had already crossed the border. Instead, the court issued a more general declaratory judgment interpreting § 1702(b)(2).

³²¹ Haitian Transactions Regulations, 31 C.F.R. § 580.206 (1993).

The Libyan Sanctions Regulations contain similar language.³²² The Iranian Transactions Regulations do not prohibit exports of goods to Iran, but apply only to transactions involving property in which Iran or Iranian entities have an interest³²³ or with respect to securities registered or inscribed in the name of Iran.³²⁴ The regulations with respect to Iraq and Yugoslavia do restrict donations of goods intended to relieve human suffering.³²⁵

B) The Trading With the Enemy Act

The two main purposes of the Trading with the Enemy Act (TWEA) are to protect national security and to aid the successful prosecution of war.³²⁶ The TWEA was formerly activated during times of war and in times of national emergency, as declared by the President. However, in 1977 the TWEA was amended so that it now only applies in times of war.³²⁷ At the same time, Congress also decided to maintain the TWEA's applicability with respect to those countries to which it applied in 1977. Each year, the President must issue a determination to continue the exercise of his authorities or the authorities exercised

³²² "Except as authorized, no goods, technology . . . or services may be exported to Libya from the United States, except publications and donated articles intended to relieve human suffering, such as food, clothing, medicine and medical supplies intended strictly for medical purposes." 31 C.F.R. § 550.202 (1993).

³²³ 31 C.F.R. § 535.201 (1993).

³²⁴ 31 C.F.R. § 535.202 (1993).

³²⁵ This authority has been delegated by the President to the Department of Treasury under the U.N. Participation Act of 1945. See *infra* text accompanying notes 363-369.

³²⁶ 50 U.S.C.A. App. § 1 (West 1990).

³²⁷ Under the TWEA, war is deemed to begin at "midnight ending the day on which Congress has declared or shall declare war or the existence of a state of war." War is deemed to end on "the date of proclamation of exchange of ratifications of the treaty of peace, unless the President shall, by proclamation, declare a prior date . . ." 50 U.S.C.A. App. § 2 (West 1990).

with respect to the specific country will automatically expire.³²⁸ Despite the absence of a declared war between the U.S. and Cambodia, Cuba, and North Korea, the TWEA still governs transactions with these countries.³²⁹

The regulations governing the countries covered by the TWEA are based on President Truman's declaration of a state of national emergency. The language in that declaration emphasized the need for the United States to protect against

world conquest by communist imperialism. . . . [For if that were to occur], the people of this country would no longer enjoy the full and rich life they have with God's help built for themselves and their children. . . . [The] increasing menace of the forces of communist aggression require[d] that the national defense of the U.S. be strengthened as speedily as possible . . . to the end that we may be able to repel any and all threats against our national security and to fulfill our responsibilities in the efforts being made through the United Nations and otherwise to bring about lasting peace.³³⁰

The passage of the Joint Resolution of March 3, 1921, -- which declared that acts of Congress passed during World War I should be construed as though the War had ended and that the then present or existing emergency had expired -- had no effect on the TWEA, which had been

³²⁸ Pub. L. No. 95-223, § 101(b)-(c). See, e.g. Presidential Determination 93-38 (Sept. 13, 1993) which extended until September 14, 1994 authorities exercised under 31 C.F.R. §§ 500, 505, 515 and 520.

³²⁹ The following regulations were most recently extended for one year, until September 14, 1996, by Presidential Determination 95-41, 60 Fed. Reg. 47659 59 Fed. Reg. 47,229 (Sept. 8, 1995): Foreign Assets Control Regulations, 31 C.F.R. Part 500; Transaction Control Regulations, 31 C.F.R. Part 505; Cuban Assets Control Regulations, 31 C.F.R. § 515; and the Foreign Funds Control Regulations, 31 C.F.R. Part 520.

These regulations affect more countries than those referred to above. However, the impact on the other countries is limited to prohibitions on the sale and purchase of certain goods (e.g., arms) and the potential blocking of assets belonging to nationals of various foreign countries.

³³⁰ Proclamation No. 2914, 15 Fed. Reg. 9020 (1950).

passed four year earlier. The TWEA was expressly excepted from the Joint Resolution's operation and effect.³³¹

The powers given to the President under the TWEA are essentially the same as those given by the IEEPA.³³² Also, as with the IEEPA, OFAC promulgates regulations prohibiting or regulating various specific transactions with regard to the countries involved. Similarly, the Secretary of Commerce is also authorized to promulgate regulations and to take other necessary steps to enforce the TWEA.³³³

As discussed above with respect to section 1702(a) of the IEEPA, the authorities granted by section 5(b) of the TWEA are broad and potentially can be used to prohibit or regulate donations. Furthermore, the power to regulate or prohibit donations under the TWEA is not as clearly limited as it is under the IEEPA. Section 38 of the TWEA allows for donations of articles "intended to be used solely to relieve human suffering" to be made to any person in any country with which the U.S. is at war once the hostilities cease.³³⁴ Although this language will likely apply to those countries that become subject to the TWEA in the future by virtue of a war with the United States, it arguably does not apply to those countries which currently fall under the TWEA by virtue of a national emergency. War can be read as a prerequisite for the applicability of section 38, as can the "cessation of hostilities."³³⁵ These two elements are not present with regard to the states of emergency that have been relied on for the current TWEA countries.

Support for this narrow reading of section 38 can be found in *Welch v. Kennedy*, which accepted as valid the restrictions placed on donations intended to finance the purchase of medical supplies to be

³³¹ 50 U.S.C.A. App. Prec. § 1, References and Annotations.

³³² Additional powers are given in the TWEA which allow the President to vest property.

³³³ 50 U.S.C.A. App. § 16 (West 1990).

³³⁴ 50 U.S.C.A. App. § 38(a) (West 1990).

³³⁵ "[T]he term 'date of cessation of hostilities' shall mean the date specified by proclamation of the President or by a concurrent resolution of the two Houses of Congress, whichever is the earlier." 50 U.S.C.A. App. § 38(b)(3) (West 1990).

sent to Vietnam.³³⁶ Faced with the plaintiffs claim that the TWEA was never intended to authorize the regulation of humanitarian medical relief to foreign nations, the *Welch* court found that:

Such an interpretation would be inconsistent with the broad purpose of the Act, which was to give the President full power to conduct economic warfare against belligerent nations in time of war or national emergency. . . . The history of administration under the Act evidences no understanding that contributions for the purchase of medical supplies are outside its terms, but rather reflects a flexible use of the delegated power to meet the exigencies of varying circumstances.³³⁷

While this case was on appeal, the hostilities between the United States and Vietnam were terminated.³³⁸ Subsequently, OFAC permitted plaintiffs donation. While agreeing that the issue was moot, the court recognized OFAC's power to limit future donations, presumably despite the cessation of hostilities:

We realize, too, that applications for licenses to transmit funds to North Vietnam will hereafter be granted or denied on the basis of factors individually involved, that conceivably the ban which appellant contested might eventually be restored, and that in either event appellant could again face the problem which precipitated his suit should he ever again seek to send a contribution to that country.³³⁹

³³⁶ Plaintiff was denied a license to send \$2000 to the Canadian Friends Service Committee, a Canadian organization which was to use the money to provide medical supplies to Vietnam. Additionally, a \$25 check that plaintiff sent to the organization was blocked by the Treasury Department. *Welch v. Kennedy*, 319 F. Supp. 945, 946 (D.D.C. 1970), *remanded sub nom. Welch v. Schultz*, 482 F.2d 780 (D.C. Cir. 1973), *vacated as moot sub nom. Welch v. Simon*, 498 F.2d 1060 (D.C. Cir. 1974).

³³⁷ *Welch v. Kennedy*, 319 F. Supp. 945, 946-47 (D.D.C. 1970).

³³⁸ *Welch v. Schultz*, 482 F.2d 780, 782 (D.C. Cir. 1973).

³³⁹ *Welch v. Simon*, 498 F.2d 1060, 1062 (D.C. Cir. 1974).

Consequently, it appears that donations can be regulated or prohibited under the TWEA with respect to those countries grandfathered under it. While section 38 was never discussed in *Welch*, that silence might suggest that it was deemed not applicable.

Additionally, the fact that restrictions on donations to the grandfathered countries may not currently exist (or may be relatively weak) does not prevent such restrictions from being instituted under the TWEA in the future.³⁴⁰ As long as the annual restatement of the TWEA's application has been made, new regulations can be implemented to the full extent of the TWEA,³⁴¹ except with regard to Cuba in certain circumstances.³⁴²

II) Export Administration Act

The Export Administration Act applies at all times. The regulations under this act are promulgated and administered by the

³⁴⁰ Current regulations prohibit the "exportation of securities, currency, checks, drafts and promissory notes" to North Korea, Cambodia, and Cuba, unless a license has been granted. 31 C.F.R. § 500.405 (1993) and 31 C.F.R. § 515.405 (1993). Other regulations deal specifically with the sending of humanitarian aid to Vietnam. However, given President Clinton's recent end of the trade embargo, these may now be moot. 31 C.F.R. §§ 500.572 and 500.573 (1993). There are no other regulations which deal specifically with the sending of humanitarian aid to the other TWEA countries.

³⁴¹ *Regan v. Wald*, 468 U.S. 222 (1984) ("And neither the legislative history nor the apparent purpose of the 1977 Act sufficiently supports the contrary contention that what Congress actually intended, despite the statutory language, was to freeze existing restrictions, so that any adjustment of pending embargoes would require the declaration of a new 'national emergency' under the procedures of IEEPA").

³⁴² The Cuban Democracy Act of 1992, 22 U.S.C.A. §§ 6001-6010 (West Supp. 1993) states that some of its provisions apply "notwithstanding any other provision of law ... and notwithstanding the exercise of authorities ... under section 5(b) of the [TWEA], the [IEEPA], or the [EAA]" *Id.* at § 6004(a). One such provision absolutely prohibits the restriction of donations of food to nongovernmental organizations or individuals in Cuba and another prohibits the restriction of exports of medicines or medical supplies, instruments or equipment to Cuba unless certain exceptions apply. *Id.* at § 6004(b), (c). Additionally, there must be a reasonable likelihood that the items shipped will not be used for torture or other human rights abuses, or reexported. *Id.* at § 6005.

Department of Commerce.³⁴³ The EAA does not seem to permit the regulation or control of the export of money (except to the extent that the money in question is export financing).³⁴⁴ The EAA does allow for restrictions on the export of "goods" and "technology."³⁴⁵

In this respect, the structure of the EAA is important. The EAA allows for export controls to be used for national security, foreign policy, and economic reasons.³⁴⁶ The type of restrictions which may be

³⁴³ Since both the emergency acts (administered by the Department of Treasury) and the EAA (administered by the Department of Commerce) can potentially apply at the same time, confusion could result over the licensing that each requires for export. However, "[t]o avoid duplicative licensing responsibilities, Treasury and Commerce generally reach agreement on which authority will issue licenses. In cases where Treasury issues licenses, Commerce recognizes them as having been granted under the EAA." SEN. JOHN HEINZ, U.S. STRATEGIC TRADE: AN EXPORT CONTROL SYSTEM FOR THE 1990s, at 8 (1991).

³⁴⁴ 50 U.S.C.A. App. § 2414(b) (West 1991) (permitting regulations which apply to "the financing, transporting, or other servicing of exports").

³⁴⁵ The term "good" is defined as "any article, natural or manmade substance, material, supply or manufactured product, including inspection and test equipment, and excluding technical data." 50 U.S.C.A. App. § 2415(3) (West 1991). The term "technology" is defined as "information and know-how . . . that can be used to design, produce, manufacture, utilize, or reconstruct goods, including computer software and technical data, but not the goods themselves." 50 U.S.C.A. App. § 2415(4) (West 1991).

"The language of [§ 2414(b)] strongly suggests that the section was designed to help implement export controls under the EAA, and that it was not intended to be an independent authority to control international payments or other financial transactions . . . Moreover, none of the other provisions of the EAA envisions general controls on financing." BARRY E. CARTER, INTERNATIONAL ECONOMIC SANCTIONS: IMPROVING THE HAPHAZARD U.S. LEGAL REGIME 145 (1988).

Barry Carter stands by his conclusion despite President Carter's EAA-based restriction on the sending of money to the Soviet Union in support of the Olympics: "Although the arguably broad use of [§ 2414(b)] for the Olympics may be a precedent, the section's clear statutory language and legislative history militate against attempts to use the section to restrict private credit that is not connected with controls on the export of goods and technology." *Id.* at 148.

³⁴⁶ 50 U.S.C.A. App. § 2402(2) (West 1991). Recognizing that "the restriction of exports from the U.S. can have serious adverse effects on the balance of payments and on domestic employment, particularly when restrictions applied by the U.S. are more extensive than those imposed by other countries," Congress places a high priority on exports, consistent with the economic, security, and foreign policy objectives of the United States Congress is concerned about exports of technology which may make significant contributions to the military potential of any country or combination of

placed on exports vary with the underlying reason for the imposition of the EAA's prohibitions.

Foreign policy export controls are not authorized for medicine or medical supplies,³⁴⁷ or with regard to donations of goods (including, but not limited to, food, educational materials, seeds and hand tools, medicines and medical supplies, water resources equipment, clothing and shelter materials, and basic household supplies) that are intended to meet basic human needs.³⁴⁸

Basic human needs are defined as "those requirements essential to individual well being: health, food, clothing, shelter, and education."³⁴⁹ Controls may be placed on these articles only when the President submits to Congress a determination that such controls are necessary and only if a law is enacted authorizing the imposition of these controls.³⁵⁰ Additionally, export controls may not be placed on medical instruments and equipment for national security reasons.³⁵¹ There are no other explicit statutory limits on the use of export controls with regard to the donation of articles.

countries which would be detrimental to the national security of the U.S. Furthermore, Congress is also concerned about the need to control exports of goods and substances hazardous to the public health and the environment which are banned or severely restricted for use in the U.S. and which, if exported, could affect the international reputation of the U.S. as a responsible trading partner. 50 U.S.C.A. App. § 2402.

According to § 2402(2), export controls are issued only after full consideration of the impact on the economy of the U.S. and only to the extent necessary. Again, "necessity" is evaluated by the impact on the military potential of any country or combination of countries which would prove detrimental to the national security of the U.S.; the impact on U.S. foreign policy or international obligations; and the impact on the domestic economy from the excessive drain of scarce materials and the reduction of the serious inflationary impact of foreign demand. *Id.*

³⁴⁷ 50 U.S.C.A. App. § 2405(g) (West 1991).

³⁴⁸ *Id.*

³⁴⁹ 15 C.F.R. § 773.5(a) (1992).

³⁵⁰ 50 U.S.C.A. App. § 2405(r) (West Supp. 1993).

³⁵¹ 50 U.S.C.A. App. § 2404(c)(5)(A)(ii) (West 1991). Export controls are not authorized for national security reasons on "agricultural commodities, including fats, oils, and animal hides and skins." 50 U.S.C.A. App. § 2404(q) (West 1991).

However, the nature of the economic and national security restrictions may themselves negate any potential for placing restrictions on donations: unless the articles intended to be donated are "scarce" and their donation will have a "serious adverse impact on the economy," they likely will not fall within the scope of authorized economic export controls.³⁵² Similarly, unless the articles intended to be donated would "make a significant contribution to the military potential of any other country or combination of countries which would prove detrimental to the national security" of the US, they will not fall within the scope of the national security export controls.³⁵³

Bearing this in mind, the regulations issued under the EAA make little mention of donations. An exception is the regulation which establishes a "Humanitarian License Procedure."³⁵⁴ This regulation, which appears to apply to all export controls regardless of the reason for which they were imposed, outlines the procedure for obtaining a valid license to send donations of articles intended to meet basic human needs. When the regulation was introduced, it was noted that in practice it is only relevant for shipments to embargoed destinations since "shipments of such items to other destinations do not require individual validated licenses."³⁵⁵ Only if the articles are of a type ordinarily restricted³⁵⁶ or are aimed to countries subject to an embargo must a donee receive a license.

Under the Humanitarian License Procedure, two-year licenses are granted, enabling donations of articles to be sent to embargoed

³⁵² See 50 U.S.C.A. App. §§ 2402(2)(C), 2406 (West 1991).

³⁵³ Additionally, the articles intended to be donated must run afoul of both the list of controlled countries, 50 U.S.C.A. App. § 2404(b) (West 1991), and the control list of goods and technologies, 50 U.S.C.A. App. § 2404(c) (West 1991), in order to fall within the national security export controls.

³⁵⁴ 15 C.F.R. § 773.5 (1992).

³⁵⁵ 51 Fed. Reg. 8,482 (Mar. 12, 1986).

³⁵⁶ Goods deemed ineligible for the humanitarian license procedure include: "commodities controlled for national security, nuclear non-proliferation or crime control reasons . . . communications intercepting devices . . . [and] items controlled for export as hazardous goods or substances. . ." 15 C.F.R. § 773.5(c) (1992).

countries³⁵⁷ as long as those donations are intended to meet basic human needs,³⁵⁸ are provided free of charge,³⁵⁹ and are monitored to "alert the donor if goods are being diverted."³⁶⁰ Based on the court's reasoning in *Veterans Peace Convoy*,³⁶¹ an argument can be made that these procedural rulings are invalid. The EAA states that foreign policy export controls are not authorized on goods intended to meet basic human needs: the procedure required by the regulation can be viewed as an export control and thus an overstepping of the boundaries created by Congress.

Where applicable, regulations issued by OFAC must be also be followed even when those issued by the Commerce Department are fulfilled. Although an export may be authorized under the Humanitarian License, exporters "should confirm with the Department of the Treasury that a particular export meets" the exceptions

³⁵⁷ In theory, the Humanitarian License Procedure applies to donations to any destination: however, in practice, it only affects shipments to the embargoed destinations, since shipments of such items to other destinations do not require individual validated licenses. The embargoed destinations are countries listed in Country Groups S and Z: Libya, Cuba, and North Korea. 51 Fed. Reg. 8482 (Mar. 12 1986), as amended by 59 Fed. Reg. 6524-01 (Feb. 10, 1994) and 57 Fed. Reg. 11576-02 (Apr. 6, 1992) (removing Vietnam and Cambodia from Country Group Z).

The countries governed by Commerce Department regulations are listed in Supplement No. 1 to 15 C.F.R. § 770.15: Group Q - Romania; Group S - Libya; Group T - Greenland, Miquelon and St. Pierre Islands, Mexico, Belize, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Panama, Bahamas, Barbados, Bermuda, Dominican Republic, French West Indies, Haiti, Jamaica, Leeward and Windward Islands, Trinidad and Tobago, Colombia, French Guiana, Guyana, Surinam, Venezuela, Bolivia, Chile, Ecuador, Peru, Argentina, Brazil, Falkland Islands, Paraguay, Uruguay; Group V - all countries not included in any other country group (except Canada); Group W - Czech Republic, Hungary, Poland; Group Y - Albania, Bulgaria, Estonia, Laos, Latvia, Lithuania, Mongolia, former U.S.S.R.; and Group Z - North Korea, Cuba.

³⁵⁸ 15 C.F.R. § 773.5(a) and (d) (1992). Supplement No. 7 to § 773 lists the kinds of items that have been determined to meet basic human needs.

³⁵⁹ 15 C.F.R. § 773.5(b) (1992).

³⁶⁰ 15 C.F.R. § 773.5(e) (1992).

³⁶¹ *Veterans Peace Convoy, Inc. v. Schultz*, 722 F. Supp. 1425, 1432 (1988).

delineated under the Treasury regulations for that particular country.³⁶² Cambodia, for example, is no longer an embargoed country. However, because it is covered by the TWEA and the regulations promulgated by OFAC, commercial transactions with Cambodia remain restricted. Thus, the general rule is that Treasury regulations override Commerce regulations in dealings with countries under the TWEA, since the former are issued pursuant to presidential declarations of national emergencies.

III) United Nations Participation Act

Section 287c of the United Nations Participation Act of 1945³⁶³ gives broad powers to the President to impose economic restrictions:

Notwithstanding the provisions of any other law, whenever the United States is called upon by the Security Council to apply measures which said Council has decided . . . are to be employed to give effect to its decisions . . ., the President may, to the extent necessary . . . investigate, regulate, or prohibit, in whole or in part, economic relations or rail, sea, air, postal, telegraphic, radio, and other means of communication between any foreign country or any national thereof or any person therein and the United States or any person subject to the jurisdiction thereof, or involving any property subject to the jurisdiction of the United States.

Based on this sweeping power, the President has the power to restrict donations of both money and goods when the Security Council so mandates.³⁶⁴

³⁶² 51 Fed. Reg. 8482 (Mar. 12, 1986) as amended by 59 Fed. Reg. 6524-01 (Feb. 10, 1994) and 57 Fed. Reg. 11576-02 (Apr. 6, 1992) (removing Vietnam and Cambodia from Country Group Z).

³⁶³ 22 U.S.C.A. § 287c (West 1990).

³⁶⁴ There is a question as to whether the Security Council could prohibit or call upon the U.N. member countries to prohibit all donations, including humanitarian aid, to certain destinations. Either the United Nations Charter or the Vienna Convention Treaty on Treaties (or both) may prevent such a blanket prohibition. Thus, any Security Council

On its face, section 287c expands the President's authorities beyond those given in any other law, including the IEEPA, the TWEA, and the EAA. The regulations issued regarding the sending of humanitarian aid to both Iraq³⁶⁵ and The Federation of Yugoslavia³⁶⁶ illustrate this enhanced power.

The regulations regarding the sending of humanitarian aid to both countries contain language which is more restrictive than would be permissible under the IEEPA. The IEEPA could not authorize restrictions on the donation of articles intended to relieve human suffering unless the required determinations were made by the President. However, the regulations under the UN Participation Act contain rather specific restrictions with respect to the donation of both food intended to relieve human suffering and medical supplies. The Iraqi Sanctions Regulations provide:

Except as otherwise authorized, no goods, technology . . . or services may be exported from the United States, or, if subject to U.S. jurisdiction, exported or reexported from a third country to Iraq, to any entity owned or controlled by the Government of Iraq, or to any entity operated from Iraq, except donated foodstuffs in humanitarian circumstances, and donated supplies intended strictly for medical purposes, the exportation of which has been specifically licensed pursuant to sections 575.507, 575.517 or 575.518.³⁶⁷

The regulations with respect to the Federal Republic of Yugoslavia (Serbia & Montenegro) are even more involved. Specific licenses may be issued on a case-by-case basis to permit exportation of donated food

mandates which limit donations may impose procedural restrictions rather than absolute prohibitions.

³⁶⁵ 31 C.F.R. §§ 575.520, 575.522 (1993).

³⁶⁶ 31 C.F.R. 585.521, 585.522, 585.524 (1993).

³⁶⁷ 31 C.F.R. § 575.205 (1993). Such restrictions were deemed invalid under the IEEPA in *Veterans for Peace*, 722 F. Supp. 1425, *see supra* text accompanying notes 315-325.

intended to relieve human suffering³⁶⁸ and donated supplies intended strictly for medical purposes.³⁶⁹ Such licenses will only be granted if the goods are provided in accordance with United Nations Security Council Resolutions in order to ensure that such donations reach the intended beneficiaries.³⁷⁰ Specific licenses must also be issued for humanitarian aid to United Nations Protected Areas of Croatia and Serb-controlled areas of Bosnia-Herzegovina.³⁷¹

³⁶⁸ Federal Republic of Yugoslavia (Serbia and Montenegro) Sanctions Regulations. 31 C.F.R. § 585.521(a) (1993).

³⁶⁹ 31 C.F.R. § 585.522(a) (1993).

³⁷⁰ 31 C.F.R. §§ 585.521(b), 585.522(b) (1993).

³⁷¹ 31 C.F.R. § 585.525 (1993).