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CROSS-BORDER PHILANTHROPY: A U.S. PERSPECTIVE

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Cross-Border Philanthropy: A U.S. Perspective

Eric M. Zolt[*]

Abstract

Americans lead the world in supporting charitable activities (both in the U.S. and abroad). For foreign charitable activities, two key questions arise:

1. *Should tax benefits support charitable activities outside the U.S.?*
2. *Should the U.S. tax system treat contributions to foreign charities differently from contributions to domestic charities?*

U.S. tax law imposes remarkably low barriers to cross-border philanthropy. Contributions to U.S. charities are deductible even if all charitable activity takes place outside the U.S. Nominally, direct contributions to foreign charities are generally not deductible for income tax purposes. Practically, donors can easily work around this restriction (at relatively low costs and complexity) by transmuting non-deductible contributions to foreign charities into deductible contributions to domestic charities.

The hard question is normative: what should the law be? This chapter provides a framework for examining the desirability of the current regime and the different factors policy-makers may find useful in considering options to either reduce or increase barriers to cross-border philanthropy.

Americans are generous, at least with respect to charitable contributions. We contribute more money (and often highly appreciated property) to fund charitable activities (both domestic and foreign) than residents of any other country.[1] While this generosity exists

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[1] Giving USA estimates that U.S. charitable giving was about $450 billion in 2019. Giving USA Foundation and Indiana University Lilly Family School of Philanthropy, 2020. *Giving USA 2020: the annual report on philanthropy for the year 2019*, Chicago, IL: Giving USA Foundation, 65. In addition, Americans engaged

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among Americans of all income levels, over the past three decades or so, there has been a dramatic increase in charitable giving (and planned charitable giving) by those at the very top of the income distribution. We can see this in both the large growth of assets held in the non-profit, tax-exempt sector as well as the number of billionaires who have pledged to give a majority of their wealth for charitable purposes. The "Giving Pledge" highlights the generosity of the ultra-wealthy and their willingness to give back to a society that helped them achieve their success.[2]

Americans also lead in funding international charitable activities.[3] Many alternatives exist to help fund charitable activities outside the U.S. For example, U.S. donors can contribute to U.S. charitable organizations that engage in direct operations in foreign countries or that make grants to foreign charitable entities, to U.S. "friends of" organizations that then transfer the funds to a designated foreign charitable organization, and to donor-advised funds with a recommendation that the funds be directed to a designated foreign charity. Tax subsidies to donors and to U.S. charitable entities support all these activities.

But Americans who contribute directly to foreign charities generally receive no income tax benefits (with exceptions for contributions made to charities in Canada, Mexico, and Israel, subject to limitations).[4] In examining whether this barrier to cross-border philanthropy makes sense, this chapter considers two key questions:

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in about 8.8 billion hours of charitable activity (with a value estimated at $195 billion). Urban Institute, 2020. *The Nonprofit Sector in Brief 2019* [online]. National Center for Charitable Statistics, Urban Institute. Available from: https://nccs.urban.org/publication/nonprofit-sector-brief-2019 [Accessed 20 September 2020].

[2] Over 200 wealthy individuals have pledged to donate the majority of their wealth to charities. *The Giving Pledge* [online]. Available from: https://givingpledge.org/ [Accessed 5 October 2020]. The Chronicle of Philanthropy each year publishes a list of the biggest donors. The Chronicle of Philanthropy, 2020. *The Philanthropy 50: Who Gives the Most to Charity* [online]. Washington, D.C.: The Chronicle of Philanthropy. Available from: https://www.philanthropy.com/specialreport/the-philanthropy-50-who-gives/228 [Accessed 5 October 2020].

[3] Global Giving estimates that the amount of foreign donations for 2019 was $29 billion. Adelman, C., Schwartz, B., and Riskin, E., 2017. *Index of Global Philanthropy and Remittances 2016.* Washington, D.C.: Center for Global Prosperity, Hudson Institute. Available from: https://www.hudson.org/research/13314-index-of-global-philanthropy-and-remittances-2016 [Accessed 21 September 2020]. For cross-country comparisons, *see* OECD, 2020. *Taxation and Philanthropy*. OECD Tax Policy Series No. 27. Paris, France: Organization for Economic Co-operation and Development, 16-17. Available from: https://www.oecd-ilibrary.org/taxation/taxation-and-philanthropy_df434a77-en [Accessed 10 January 2021].

[4] Bilateral treaties between the U.S. and these countries allow U.S. citizens and residents to claim foreign charitable deductions against foreign source income. *United States – Canada Income Tax Convention, art. XXI*, 1984. Opened for signature 28 June 1984, entered into force 16 August 1984. Available from: http://www.irs.gov/pub/irs-trty/canada.pdf [Accessed 5 October 2020]; *Convention Between the Government of the United States of America and the Government of the State of Israel With Respect to Taxes of Income*, 1975. Opened for signature 20 November 1975, entered into force 1 January 1995. Available from: http://www.irs.gov/pub/irs-trty/israel.pdf [Accessed 5 October 2020]; *United States – Mexico Income Tax Convention, art. 22*, 1993. Opened for signatures and entered into force 28 December 1993. Available from: http://www.irs.gov/pub/irs-trty/mexico.pdf [Accessed 5 October 2020].

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1. Should tax benefits support charitable activities outside the U.S.?

2. Should the U.S. tax system treat contributions to foreign charities differently from contributions to domestic charities?

Under current law, U.S. tax barriers to cross-border philanthropy are remarkably low.[5] Contributions to U.S. charitable organizations are deductible even if all charitable activity takes place outside the U.S. Direct contributions to foreign charities are generally not deductible for income tax purposes. But, because many alternatives are available under US law to channel contributions to foreign charities, this prohibition merely increases the complexity and transaction costs of giving to foreign charities. Nominally, the U.S. tax system treats contributions to foreign charities differently than contributions to domestic charities. Practically, donors generally can transmute non-deductible contributions to foreign charities into deductible contributions to domestic charities pretty easily.

The harder question is normative: what should the law be? It depends on how one frames the inquiry. One approach focuses on whether there are meaningful differences between U.S. and foreign charitable activities and between domestic and foreign charities that justify different tax treatment. This approach requires looking at the different rationales for charitable tax subsidies for guidance that might apply to warrant differential treatment. Unfortunately, the different theories that support using tax benefits to support charitable activities provide remarkably little guidance as to what types of activities merit favorable tax treatment and whether to extend such subsidies to foreign charitable activities or foreign charities. While strong arguments exist that the theories supporting charitable tax subsidies do not justify privileging domestic activity (or prohibiting or limiting subsides for foreign charitable activity), it is not clear a finding of "no sufficient difference" justifies tax subsidies for foreign charitable activities.

A second approach examines whether the current U.S. approach is the most effective way to achieve societal objectives for supporting charitable activities, including foreign activities. This second approach requires considerations of the efficacy of the current tax regime for both domestic and foreign charitable activities as well as other alternatives the U.S. government could adopt to provide financial support and other incentives to charitable activities. The question is easy to state: do the costs of the charitable tax subsidies exceed the benefits from the incremental charitable activities resulting from the tax subsidies? The answer is a lot more difficult. It requires looking at who benefits from charitable tax subsidies (both donors and recipients of charitable goods and services), who bears the costs of the tax subsidies, and who decides how to spend the funds attributable to these subsidies. It also requires consideration of factors that may justify greater tax incentives for domestic charitable activities than foreign charitable activities. Under this approach, it is not possible to answer the question of whether U.S. tax subsidies should support foreign charitable

[5] As discussed in Part 1.C, U.S. charities are subject to a host of non-tax requirement including laws covering counter-terrorism, anti-money laundering, foreign corrupt practices, boycotts, and sanctions. These regimes likely pose a greater barrier to cross-border philanthropy than tax requirements.

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activities and foreign charities without going back to examine the U.S. charitable tax regime for both domestic and foreign activities.

Five observations help shape the discussion of using tax subsidies for domestic and foreign charitable activities.

First, we lack a comprehensive theory that marries tax subsidies to the current collection of qualified charitable activities and charitable organizations. The current tax regime reflects a set of trade-offs that result in a robust charitable sector and contributes to the diversity, pluralism, and even cacophony that are important in our society.[6] It is unclear whether these same trade-offs would apply to foreign charitable activities and foreign charities.

Second, the choice of whether to extend tax subsidies to foreign charitable activities or foreign charities need not be binary (that is, either deny tax subsidies for foreign activities or foreign charities or adopt tax subsidies that do not differentiate domestic and foreign charitable activities or charities). Another option provides tax subsidies for foreign activities and charities that are less expansive (either by adopting a different standard of charitable purpose or more restrictive contribution limitations) than those available to domestic activities.

Third, determining the efficacy of charitable tax subsidies requires consideration of all tax benefits for charitable activity, not just the charitable deduction under the personal income tax. These include income tax benefits for contributions of appreciated property, the reduced estate tax liability resulting from both lifetime and testamentary giving, and the loss of tax revenue from large transfers of assets from the taxable to the tax-exempt sector.

Fourth, the decision to provide tax subsidies for domestic and foreign charitable activities may require policy makers to compare the relative contribution of donors (the after-tax value of their donation) with the effective matching grant provided by government tax subsidies. They could then consider whether the current regime is at a "tipping point" where wealthy donors have too much control in deciding how government funds are spent.

Finally, accountability and oversight considerations play an important role in both understanding current aspects of the U.S. regime for cross-border philanthropy and providing a rationale for different treatment for foreign charitable activities and charities across different countries.

Part I reviews some of the important tax and other regulatory provisions that apply to charitable organizations and to donors. Part II examines some of the implications of using the tax system to subsidize charitable activities. Part III examines whether tax subsidies

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[6] Dale, H.P., Commentary on Zolt, E.M., 2011. 'Tax Deductions for Charitable Contributions: Domestic Activities, Foreign Activities, or None of the Above' [presentation]. NYU School of Law Colloquium on Tax Policy and Public Finance, 10 March 2011 (on file with the Author).

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should support charitable activities outside the U.S. Part IV considers whether the tax law should treat contributions to foreign charities differently than contributions to domestic charities as well as some proposed reforms that would encourage cross-border philanthropy. Part V provides some conclusions.

I. Regulatory Regime for Charitable Activities

This section reviews briefly the current tax regime that applies to charitable organizations and to those donors who contribute to these charities.

A. Tax Rules for Charitable Organizations

U.S. tax law provides two major types of tax benefits for charitable organizations.[7] First, the tax law provides an exemption from income tax for income related to the organization's charitable purpose and for investment income. Second, qualified charities are eligible to receive tax-deductible contributions for income, estate, and gift tax purposes. These two tax subsidies substantially reduce the after-tax costs of contributing to these charities for donors. In addition to these federal tax benefits, charitable organizations may have access to tax-exempt financing and qualify for state and local income, sales, and property tax benefits.

To qualify for tax-exemption, U.S. tax law requires that the charitable organization be organized and operated for one of the enumerated charitable purposes. These activities include the usual suspects (religious, charitable, scientific, and educational purposes) as well as some activities that are less obvious (fostering amateur sports competition and for the prevention of cruelty to children or animals).

Additional statutory requirements for qualification ensure that the charitable organizations do not spill over to other non-charitable goals. They include a prohibition against "private inurement," to prevent the organization from providing benefits to insiders and related persons. Similarly, organizations cannot engage in political campaign activity or excessive lobbying. Most important for our purposes is a geographical limitation. Only donations made to charities organized or created in the U.S. or its possessions can qualify for the charitable income tax deduction. Foreign charities can qualify for tax-exemption by complying with the same application procedures that apply to domestic charities. This status allows foreign charities to avoid federal income tax on their charitable activities and investment income but does not allow U.S. donors to claim income tax deductions for contributions to these foreign charities.

Different types of charitable organizations. Charitable organizations in the U.S. come in different flavors. The tax law divides charities into private foundations and public charities. "Traditional public charities" are what most people think of as charitable organizations, such as the YWCA or the Red Cross. Different types of charitable organizations may

[7] This discussion is adapted from Oh, J. and Zolt, E., 2021. Wealth Tax Design: Lessons from Estate Tax Avoidance. *Tax Law Review*, 74 (forthcoming).

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qualify for public charity status.[8] The first category provides public charity status either because of the nature of an organization's activities or because of the broad financial support received.[9] This category includes educational organizations, religious institutions, and hospitals and medical research organizations. A second category of public charities are organizations that receive more than one-third of their support from gifts, grants, fees, and receipts of sales of goods and services related to their exempt purposes.[10] Public charity status provides more generous income tax benefits for donors than contributions to private foundations and allows charitable entities to avoid a host of excise taxes, minimum distribution requirements, and restrictions that apply to private foundations.[11]

Charitable organizations that do not qualify as public charities are private foundations. While they differ greatly in size and nature of activities, they share a common feature—that a small group of donors (individuals, families, or corporations) controls them. Two types of private foundations exists: one, private operating foundations that engage directly in charitable activities, and two, private foundations that hold assets for grants to other charitable organizations.[12] Because of a history of abuses involving private foundations, U.S. tax law provides for several measures to reduce self-dealing and other abuses and requires a minimum annual distribution.[13] For tax years beginning after December 20, 2019, private foundations are subject to a 1.39% excise tax on their net investment income.[14]

For purposes of cross-border philanthropy, the key difference between public charities and private foundations is the additional requirements imposed on private foundations for grants made to foreign charities. Unless the foreign charity has received a determination letter from the IRS that it meets the standards to qualify as a U.S. public charity, private foundations need to comply with certain regulatory requirements. Private foundations are required to either exercise expenditure responsibility with respect to the grant or make a good faith determination that the foreign charity is the equivalent of a U.S. public charity. Failure to comply results in tax and other penalties.

To exercise expenditure responsibility, a private foundation must conduct a pre-grant inquiry of the foreign charity to ensure that the funds will be used for the intended charitable purposes. Expenditure responsibility also requires the foundation (i) to enter into a written agreement with the foreign charity that requires the foreign charity to return any

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[8] Dale, H.P. and Colinvaux, R., 2015. The Charitable Contributions Deduction: Federal Tax Rules. *Tax Lawyer*, 68(2), 331-366.
[9] I.R.C. §§ 509(a)(1), 509(a)(2)(A) (2006); I.R.C. § 170(b)(1)(A)(i)-(iv) (2018).
[10] I.R.C. § 509(a)(2)(B) (2006). A third category of public charity status is for supporting organizations qualifying under I.R.C. § 509(a)(3) (2006).
[11] I.R.C. §§ 4940-4948 (2019).
[12] The major distinction between the two types of private foundations is how they spend their funds. A private operating foundation must annually spend at least 85 percent of its investment income on direct charitable expenditures, while a private non-operating foundation must annually distribute at least five percent of its assets in charitable grants and related expenses. *Id.* at § 4942.
[13] I.R.C. §§ 4940-4945 (2019).
[14] I.R.C. § 4940 (2019).

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funds not used for the charitable purpose; (ii) to exert all reasonable efforts to ensure the funds are spent solely for the purposes the grant was made; (iii) to obtain full and complete reports from the foreign charity on how funds were spent; and (iv) to make full and detailed reports to the IRS about the funds transferred to the foreign charity.

Private foundations can also avoid excise taxes and other penalties on grants to foreign charities by making a good faith determination that the foreign charity is the equivalent of a U.S. public charity. An organization is equivalent to a U.S. public charity if it is organized, operated, and funded like a U.S. public charity. Before 2015, private foundations could rely on an affidavit from a foreign charity establishing that the organization was the equivalent of a Section 501(c)(3) organization. Treasury regulations provide that private foundations can satisfy the equivalency requirement by obtaining written advice from a qualified tax practitioner that the foreign charity satisfies the requirements for qualified public charity status.[15] In 2017, the IRS issued guidelines that sets forth the types of documents, affidavits, representations, and financial information that tax practitioners should compile and review in providing written advice to private foundations to support an equivalency determination.[16] Organizations, such as NGOsource, have substantially reduced the costs and challenges of establishing equivalency determination by providing private foundations (and donor-advised funds) with access to their repository of foreign charities satisfying the U.S. public charity equivalency requirement or by providing legal assistance in confirming equivalency for foreign charities not in their repository.[17]

In the post-September 11, 2001 world, the differences between the oversight requirements for public charities and private foundations have narrowed substantially. As set forth in Part I.C, while public charities are not subject to expenditure responsibility or equivalency determinations for grants to foreign charities, they must engage in sufficient due diligence and monitoring of funds to avoid penalties under counter-terrorism and anti-money laundering laws.

Donor-Advised Funds. One major change in the U.S. charitable landscape over the last decade is the growth of donor-advised funds.[18] These funds offer a hybrid approach to charitable giving that allows a donor to achieve a substantial measure of informal control over the investment and ultimate disposition of the donated property while qualifying for the less onerous rules and more generous tax benefits of a public charity.[19] A donor-advised

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[15] Treas. Reg. § 53.4945-5.
[16] Rev. Proc. 2017-53.
[17] NGOsource is a project of TechSoup and the Council on Foundations that seeks to increase the level of cross-border philanthropy by facilitating the availability and reducing the cost to private foundations and donor-advised funds of satisfying the equivalency determination requirement. *NGOsource* [online]. Available from: https://www.ngosource.org/ [Accessed 11 November 2020].
[18] In 2018, contributions to donor-advised funds exceeded $37 billion, or about 12.7% of individual charitable giving, and assets in donor-advised funds exceeded $120 billion. National Philanthropic Trust, 2019. *2019 Donor-Advised Fund Report*. Jenkintown, PA: National Philanthropic Trust, 7-13.
[19] Donor-advised funds are not the only approach that weds the substantial control of private foundation with the benefits of a public charity. Donors can work with an existing charitable organization to set up so-called

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fund is a fund or account at a qualified public charity (called a "sponsoring organization") over which the donor or donor-appointed advisor retains advisory privileges regarding the investment or distribution of assets in the fund or account.[20] Donors irrevocably transfer funds to the sponsoring organization and can claim an income tax deduction when funds are transferred even though donors generally retain the ability to provide advice as to the ultimate charitable beneficiary and often to direct how the funds are invested. While the sponsoring organization has legal authority over how the funds will be invested and transferred, as a practical matter the "advisory" power of the donor will almost always be respected. [21]

A rapidly growing phenomenon is the affiliation of sponsoring organizations with financial institutions (such as Fidelity Charitable Gift Fund, Vanguard Charitable Endowment Program, Schwab Charitable Fund, and Goldman Sachs Philanthropy Fund).[22] The charitable organizations affiliated with financial institutions have seen a rapid increase in both the number of donor-advised funds and assets placed in donor-advised funds. [23] These sponsors have succeeded in creating a relatively simple device that allows donors to time their charitable contributions to get the maximum tax benefits while retaining control over where and when the contributions to traditional public charities will be made (as well as determining how the assets will be managed in the interim).

Donor-advised funds provide an easy mechanism for donors to designate contributions to foreign charities, thus avoiding the non-deductibility rules for direct contributions to foreign charities. Similar to the requirements imposed on private foundations, donor-advised funds making grants to foreign charities must either make a determination that the

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"supporting organizations," which the Internal Revenue Code establishes as a third category of public charities. These supporting organizations derive their public charity status through their relationship with their supported organization. IRS, 2020. *Supporting Organizations – Requirements and Types* [online]. Washington, D.C.: Internal Revenue Service. Available from: https://www.irs.gov/charities-non-profits/charitable-organizations/supporting-organizations-requirements-and-types [Accessed 5 October 2020]; *see generally* Bjorklund, V.B., 2003. Choosing Among the Private Foundation, Supporting Organization, and Donor-Advised Fund. *Charitable Giving Techniques*, Chicago, I.L.: ALI-ABA, 73.

[20] I.R.C. § 4966(d)(2) (2006).

[21] Department of the Treasury, 2011. *Report to Congress on Supporting Organizations and Donor Advised Funds.* Washington, D.C.: Department of the Treasury. Available from: https://www.treasury.gov/resource-center/tax-policy/Documents/Report-Donor-Advised-Funds-2011.pdf [Accessed 20 September 2020]. Traditionally, sponsoring organizations were either community foundations or single-issue charities. Community foundations are charitable organizations with a particular geographic or regional focus. Single-issue charities are organizations formed to promote a single issue, a religion, or an institution. For a good discussion of the different types of donor-advised funds and the growth in number of funds, grants to charitable institutions, and total contributions to donor-advised funds, *see* National Philanthropic Trust, 2019. *2019 Donor-Advised Fund Report*. Jenkintown, PA: National Philanthropic Trust. Available from: https://www.nptrust.org/reports/daf-report/ [Accessed 20 September 2020].

[22] Hester, M.C., 2008. Donor-Advised Funds: When Are They the Best Choice for Charitably Minded Clients?. *Journal of Taxation*, 108(6), 330-346.

[23] Feinschreiber, S., 2007. *Smart Giving*. Research Insights Report. Boston: Fidelity Investments. Available from: http://personal.fidelity.com/myfidelity/InsideFidelity/NewsCenter/mediadocs/Smart_Giving_Report.pdf [Accessed 5 October 2020].

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foreign charity is equivalent to a U.S. public charity or exercise expenditure responsibility over the grants to avoid tax penalties.[24] Sponsors of donor-advised funds have adopted different policies for contributions to foreign charities recommended by donors. One approach allows donors to recommend distributions to foreign charities but limits potential recipients to those foreign charitable organizations that have received a Section 501(c)(3) determination letter. A second option allows contributions to foreign charities but effectively channels the contribution through an American intermediary charity that will then make a grant to the foreign charity.[25] Finally, sponsors of donor-advised funds can partner with organizations that can conduct due diligence of foreign charities and provide evidence of equivalency determination to a U.S. public charity.[26]

"Friends of" Organizations. U.S. tax law allows donors to claim a charitable deduction for contributions made to a U.S. intermediate entity even if the intermediate entity transfers funds to a designated foreign charity.[27] As long as the organization does not act as a "mere conduit" to the foreign charity, U.S. donors can secure deductions for charitable contributions that are effectively made to foreign charities.[28]

These "friends of" organizations must satisfy several requirements.[29] First, the organization must not be required to transfer funds to the foreign charity by either charter or bylaw provision or by the terms of the gift. Second, the gift to the foreign organization must be within the intermediate entity's mission and purpose. Finally, the organization must exercise due diligence in determining that the foreign charity qualifies as an eligible organization. If the "friends of" organization qualifies as a public charity, then it can avoid the expenditure responsibility requirements that apply to private foundations. IRS guidelines require that the "friends of" organization not be controlled by the foreign charity.[30] A search of the Charity Navigator reveals at least 1,000 friends of organizations that have "American Friends of" in the name of the charity.[31]

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[24] Treas. Reg. § 53.4945-5(b).

[25] For example, the Fidelity Charitable Gift Fund facilitates contributions to foreign charities through CAF America, Give2Asia, Global Giving, and King Baudouin Foundation United States. Fidelity Charitable, 2020. *Giving Internationally* [online]. Available from: https://www.fidelitycharitable.org/private-donor-group/giving-internationally.html [Accessed 6 October 2020].

[26] *See, for example, Giving to international charities* [online]. Schwab Charitable. Available from: https://www.schwabcharitable.org/public/charitable/features/where_to_give/giving_internationally [Accessed 5 October 2020].

[27] *See generally* Dale and Colinvaux, *supra* note _, Rev. Rul. 66-79, 1966-1 C.B. 48 and Rev. Rul. 74-229, 1974-1 C.B. 142. Bjorklund, V.B. and Reynoso, J.I., 2005. *How a Private Foundation Can Use "Friends of" Organizations* [online]. Council on Foundations. Available from: https://www.cof.org/content/how-private-foundation-can-use-friends-organizations [Accessed 20 September 2020].

[28] Rev. Rul. 74-229, 1974-1, C.B. 142.

[29] Dale and Colinvaux, *supra* note __ at __.

[30] Bjorklund and Reynoso, *supra* note_ at _. Tax advisors generally recommend a governance structure whereby U.S. citizens not affiliated with the foreign charity can exercise control.

[31] While it is common to have the "American Friends of" in the name of the intermediary organization, it is not required. Therefore, the total number of friends of organization is likely greater than those included in the Charity Navigator search.

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In addition to formal "friends of" status, foreign charities can get de facto status by contracting with an intermediary U.S. charity. For example, CAF America has established a "friends fund" that allows foreign charities to avoid the application and reporting requirements under U.S. tax law but still allow U.S. donors to receive charitable deductions for funds directed to foreign charities.[32]

B. Tax Rules for Donors

Since 1917, the U.S. has allowed individuals and corporations to deduct contributions made to qualified charitable organizations for income tax purposes. Various limitations on the amounts deductible apply depending on the type of donee (public charity or private foundation) and type of property contributed (cash or non-cash property contributions).

Under current temporary provisions, individuals can deduct cash contributions to public charities subject to a limitation of 60% (100% for contributions made in 2020) of their adjusted gross income.[33] For non-cash individual charitable contributions to public charities, the limitation is 50% of adjusted gross income unless the property is long-term capital gain property in which case a 30% limitation applies.

Less favorable rules apply to contributions to private foundations. Generally, individuals can deduct 30% of their adjusted gross income for contributions of cash and short-term capital gains property and only 20% of their adjusted gross income for contributions of long-term capital gain property. For contributions to either public charities or private foundations, individuals can carry forward charitable contributions that exceed the limitations for up to 5 years.

Except for a temporary exception provided in the Coronavirus Aid, Relief, and Economic Security (CARES) Act[34] and extended by the Consolidated Appropriations Act, 2021,[35] individuals who take the standard deduction rather than itemizing receive no income tax benefits for charitable contributions. One major consequence of the Tax Cuts and Jobs Act of 2017 (TCJA) is the dramatic increase in the number of taxpayers in this category. Before

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https://www.charitynavigator.org/index.cfm?FromRec=0&keyword_list=american+friends+of&bay=search.results. A high percentage of these organizations are affiliated with religious charities, mostly in Israel.

[32]The cost to the foreign charity is an annual fee of $3,500 plus a transaction cost on funds received from U.S. donors and transferred to the foreign charity. For a description of the CAF America friend fund, *see* CAF America, 2019. *"Friends of" Organization vs. Friends Fund.* Available from: https://www.cafamerica.org/wp-content/uploads/FriendsFundv501c3_CAFAmerica.pdf [Accessed 11 November 2020].

[33] Contributions to private operating foundations generally qualify for the same limitations as contributions to public charities. I.R.C. § 4942(j)(3).

[34]Section 2204 of the CARES Act amends I.R.C. § 62(a)(22) to provide for a $300 deduction for cash charitable contributions made in 2020 by taxpayers who do not itemize personal deductions. Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, 134 Stat. 281.

[35] Section 212 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020 contained within the Consolidated Appropriations Act, 2021 extends and modifies the $300 charitable deduction for non-itemizers for tax year 2021 and increases the maximum amount that may be deducted to $600 for married couples filing jointly. Consolidated Appropriations Act, 2021, Pub. L. No. 116-260, 134 Stat. 1182.

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the TCJA, about 69% of taxpayers took the standard deduction. Because of the increase in amount of the standard deduction (and limitations put on other personal deductions -- most notably, the state and local tax deductions), more than 90% of taxpayers will elect to claim the standard deduction – and get nothing for their charitable contributions.[36] The itemizers are disproportionately from the upper end of the income distribution.

Donors contributing appreciated property generally receive a less widely recognized second tax benefit on top of the well-known charitable deduction. They can claim a deduction equal to the fair market value of the appreciated property without paying any capital gains tax on the pre-transfer appreciation.[37] While contributions of appreciated property to private foundations are generally limited to the tax basis in the property, a special exception applies to contributions of appreciated publicly traded stock.[38] As examined further in Part II.D, for many donors the economic value of avoiding any tax on pre-transfer appreciation (and the resultant loss of potential tax revenue) dwarfs the tax benefit from claiming a charitable deduction for income tax purposes.

Individuals (and estates) can also receive tax benefits for charitable contributions under the estate and gift tax. For 2020, the estate and gift tax exemption is $11.58 million per individual (a married couple will have an exemption of $23.16 million). For taxable estates of $1 million or more, the estate tax rate is 40%. In 2019, charitable giving through estates amounted to about $43 billion, resulting in reduced estate tax revenue of roughly $17 billion (about one-third of the annual revenue loss from the charitable income tax deduction).[39]

Wealthy donors generally engage in more charitable giving at death than through lifetime charitable contributions. For net estates between $50 to $100 million, testamentary giving exceeds charitable giving in the last 5 years of life by a factor of 10.[40] For estates over $100

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[36] For an analysis of how the TCJA reduced the percentage of taxpayers who will claim itemized deductions (including the deduction for charitable contribution), *see* Tax Policy Center, 2020. Key Elements of the U.S. Tax System [online]. *In: Tax Policy Briefing Book*. Washington, D.C.: Urban-Brookings Tax Policy Center. Available from: https://www.taxpolicycenter.org/briefing-book/how-did-tcja-change-standard-deduction-and-itemized-deductions [Accessed on 8 October 2020].

[37] Halperin, D., 2002. A Charitable Contribution of Appreciated Property and the Realization of Built-in Gains. *Tax Law Review* 56(1), 1-38; Colinvaux, R., 2013. Charitable Contributions of Property: A Broken System Reimagined. *Harvard Journal of Legislation* 50(263), 263-329.

[38] Donors can deduct the fair market value of "qualified appreciated stock" without reduction for any long-term capital gain that the donor would have recognized on the sale of the stock. I.R.C. § 170(e)(5). For these purposes, qualified appreciated stock is stock traded on an established securities market and donated stock may not be more than 10% of the corporation's outstanding stock.

[39] Giving USA, *supra* note __ at __.

[40] Steurle, C.E., 2008. *Patterns of Giving by the Wealthy*. Washington, D.C.: Urban Institute. Available from: https://www.urban.org/research/publication/patterns-giving-wealthy [Accessed 20 September 2020]. For support for the proposition that the estate tax increases both charitable bequests at death and charitable donations during life, *see* Greene, P., 2009. *Federal Estate and Gift Taxes*. Economic and Budget Issue Brief. Washington, D.C.: Congressional Budget Office. Available from: https://www.cbo.gov/sites/default/files/111th-congress-2009-2010/reports/12-18-estate_gifttax_brief.pdf [Accessed 5 October 2020] (citing Joulfaian, D., 2009. On Estate Tax Repeal and Charitable Bequests. *Tax*

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million, testamentary transfers are 20 times greater than giving in the last five years of life.[41] The amounts of charitable contributions are substantial. For estates over $50 million, charitable contributions as a share of the net estate exceed 40%.[42]

C. Non-Tax Requirements for U.S. Charitable Organizations

While the IRS is responsible for recognizing tax-exempt status and monitoring charities' activities, charitable organizations are also subject to regulation at the state level. In the U.S., charitable entities are organized or incorporated under state law and are subject to supervision by various state agencies. Each state has a non-profit statute that governs the allowable purposes for non-profit status as well as rules governing the operation and dissolution of charities. States vary greatly in the resources devoted to monitoring charitable activity as well as types of enforcement activities.[43] Many states require non-profits to register before engaging in fundraising activities and have local solicitation laws to protect donors from deceptive charities.

In addition to IRS and state supervision, charitable organizations are subject to several regulatory regimes that seek to prevent diversion of charitable assets for illicit purposes. These include counter-terrorism laws as well as laws targeting money laundering and corruption. Shortly after the September 11, 2001 terrorist attacks, President George W. Bush signed Executive Order 13224 which required the U.S. Department of Treasury to maintain a list of known and suspected terrorists and impose sanctions on those individuals or organizations who support or are associated with those on the list. The primary U.S. terrorist list is the Specially Designated Nationals List maintained by the U.S. Treasury's Office of Foreign Asset Control.[44] Charitable organizations that provide funds, goods, or

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Notes, 123(10), 1221-1229, *and* McClelland, R., and Greene, P., 2004. *The Estate Tax and Charitable Giving*. Washington, D.C.: Congressional Budget Office. Available from: https://www.cbo.gov/sites/default/files/108th-congress-2003-2004/reports/07-15-charitablegiving.pdf [Accessed 5 October 2020]).

[41] Steuerle *et al.*, *supra* note __, at tbl.4.

[42] *Id.* at tbl.5. For estates of all sizes making charitable bequests, the charitable bequests were approximately 20% of total gross assets of the estate.

[43] Adelstein, S. and Borise, E.T., 2018. *State Regulation of the Charitable Sector: Enforcement, Outreach, Structure and Staffing.* Washington, D.C.: Urban Institute. Available from: https://www.urban.org/research/publication/state-regulation-charitable-sector [Accessed 20 September 2020].

[44] Office of Foreign Assets Control, 2020. *Specially Designated Nationals and Blocked Persons List*. Washington, D.C.: U.S. Department of the Treasury. Available from: https://www.treasury.gov/ofac/downloads/sdnlist.pdf [Accessed 9 October 2020]. The U.S. Department of Justice maintains a Terrorist Exclusion List. Bureau of Counterterrorism, 2020. *Terrorist Exclusion List.* Washington, D.C.: U.S. Department of State. Available from: https://www.state.gov/terrorist-designations-and-state-sponsors-of-terrorism/ [Accessed 20 September 2020]. Both the United Nations and European Union maintain list of suspected terrorists and terrorist organizations. United Nations Security Council, 2020. *United Nations Security Council Consolidated List.* New York: United Nations. Available at: https://scsanctions.un.org/fop/fop?xml=htdocs/resources/xml/en/consolidated.xml&xslt=htdocs/resources/xsl/en/consolidated.xsl [Accessed 20 September 2020]; The Council of the European Union, 2020. *EU terrorist list.* Brussels: European Council and Council of the European Union. Available from:

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services to listed terrorists or terrorist organizations can have their assets frozen or their tax-exempt status revoked, even if they did not knowingly support terrorist activity.

Additional potential penalties are included in the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001,[45] which was enacted about a month after Executive Order 13224 was signed. The Patriot Act imposes civil and criminal penalties on nonprofits and their directors if they are found to have provided material support to terrorists. In 2002, Treasury issued Voluntary Guidelines (later revised) that sought to provide "best practices" for charitable organizations to follow in making grants to foreign grantees.[46] The Voluntary Guidelines set forth the types of information that the nonprofit should obtain from grantees as well as the appropriate due diligence the nonprofit should conduct before making any grants.

U.S. charitable organizations can subject themselves to additional governance and operating requirements by joining organizations that require members to meet certain standards to maintain membership. InterAction is an alliance of 190 U.S.-based non-governmental organizations that work in developing countries. Members of InterAction agree to comply with a set of standards that provide a broad code of conduct covering governance, financial reporting, fundraising, public relations, management practice, human resources and program services. [47]

II. Charitable Tax Subsidies

Before focusing on foreign charitable activities and foreign charities, this part examines four key questions related to tax subsidies: first, what theories justify favorable tax treatment; second, what is the optimal level of charitable tax subsidies; third, what are the funding and allocation alternatives for charitable contributions; and fourth, when one considers all charitable tax subsidies (not just the charitable deduction under the federal income tax), what can we say about the relative split between donors (amount of the after-

https://www.consilium.europa.eu/en/policies/fight-against-terrorism/terrorist-list/ [Accessed 20 September 2020].

[45] Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001, Pub. L. No. 107-56, 115 Stat. 272.

[46] U.S. Department of the Treasury, 2002. *U.S. Department of Treasury Anti-Terrorist Financing Guidelines: Best Practices for U.S.-Based Charities*. Washington, D.C.: U.S. Department of the Treasury. Following comments from the charitable sector and others on a 2005 revised draft issued for public comments, the Treasury Department issued new, revised guidelines. U.S. Department of the Treasury, 2006. *U.S. Department of Treasury Anti-Terrorist Financing Guidelines: Best Practices for U.S.-Based Charities*. Washington, D.C.: U.S. Department of the Treasury. Available from: https://www.treasury.gov/resource-center/terrorist-illicit-finance/Pages/protecting-charities-intro.aspx [Accessed 21 September 2020].

[47] Silver, N., 2017. *Regulating the Foreign Activities of Charities: A Comparative Perspective*. Edmonton, Alberta: The Pemsel Case Foundation at 14. Available from: https://www.pemselfoundation.org/wp-content/uploads/2017/07/Regulating-the-Foreign-Activities-of-Charities-July-25-2017.pdf [Accessed 11 November 2020]; InterAction, 2018. *InterAction NGO Standards.* Available from: https://www.interaction.org/documents/interaction-ngo-standards/ [Accessed 11 November 2020].

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tax contribution) and the government (reduced tax revenue) of funding for charitable activities.

A. Theories Justifying Charitable Tax Subsidies

Tax scholars in the U.S. have taken different approaches in examining the justifications for tax subsidies for charitable activities.[48] The literature falls into two general categories. One group of scholars focuses primarily on the donor. They justify allowing tax deductions for charitable contributions based on considerations of designing the proper base for taxation and income measurement. A mostly different group of scholars justifies tax benefits for charitable deductions and for charitable organizations as a subsidy for collective goods and services. The difference is important. The donor-based theories are rooted in the design of a tax system. In contrast, the subsidy-based theories seek to use the tax system as a means to achieve non-tax objectives, in this case, increasing incentives for private donors to support and monitor charitable activities and providing matching funds to supplement their efforts.

Donor-oriented approaches. Early examinations of the role of charitable deductions in an ideal tax system worked within the *Haig-Simons* framework, which defines income as the sum of personal consumption ("private preclusive use") plus wealth accumulation over a given time period.[49] Considering this definition of income, amounts transferred as charitable contributions are not income to the donor because they do not result in exclusive personal consumption. Instead, such contributions create common goods whose enjoyment is not limited to contributors, nor apportioned among contributors according to amounts of contributions. Under the donor-oriented approach, no government subsidy for charitable contributions exists, as the contributed amounts are not income in the first place.

One could also allow a charitable deduction because it equitably accounts for loss of welfare by the donor.[50] Society should reward those who transfer private resources for the public good. In addition, as donations often derive from perceived moral obligations, the involuntary nature of the transfer should not require taxing the donor on such amounts.

Tax scholars have offered serious challenges to both donor-oriented approaches.[51] While these theories reflect a common intuition that money (or other property) transferred to

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[48] This section borrows heavily from Zolt, E.M., 2012. Tax Deductions for Charitable Giving: Domestic Activities, Foreign Activities, or None of the Above. *Hastings Law Journal*, 63(2), 361-410.

[49] Andrews, W.D., 1972. Personal Deductions in an Ideal Income Tax. *Harvard Law Review*, 86(2), 309-385 at 313.

[50] Bittker, B.I., 1972. Charitable Contributions: Tax Deductions or Matching Grants. *Tax Law Review*, 28(1), 37-64 at 46-49.

[51] *See generally* Gergen, M.P., 1988. The Case for a Charitable Contributions Deduction. *Virginia Law Review*, 74(8), 1393-1450; Kelman, M.G., 1979. Personal Deductions Revisited: Why They Fit Poorly in an "Ideal" Income Tax and Why They Fit Worse in a Far from Ideal World. *Stanford Law Review*, 31(5), 831-884.

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charity should qualify for income tax deductions, the theoretical basis for charitable deductions as a way of accurately measuring income remains shaky.

These donor-oriented theories provide little or no guidance as to what types of charitable activities warrant support or whether giving for domestic activities should be preferred over giving for foreign charitable activities. As long as the donor gives up control of the property, it does not matter how or where the donated resources are actually used. These theories justify the tax deduction because donors are worse off because of their charitable donations. Interestingly, to the extent that geographic distance between the donor and the beneficiaries makes it harder for a donor to achieve reputational, social, or financial advantages from donations, one could argue that donor-centric theories justify preferences for foreign charitable activity over domestic activity.[52]

Subsidy-oriented approaches. A second approach justifies the charitable deduction (and other tax benefits) as a subsidy for certain types of under-provided collective goods and services. There are several strands of the subsidy literature, focusing on different types of market failure or government failure. The market failure arguments generally start with examination of public goods—those goods where one person's consumption does not reduce availability to others ("non-rival") and there is no way to exclude others from enjoying the good ("non-excludable").[53] Such goods will be under-supplied because self-interested individuals will choose to free ride on the charitable activities of others rather than pay to support the goods and services themselves. As a practical matter, most goods provided by governments (and charities) are rival and excludable. These goods and services include schools, hospitals, roads, and various transfer payments. However, these goods and services can generate externalities that are not fully captured by market participants. There is thus a role for governments (and charities) to supply such goods where there are substantial secondary benefits. Allowing a tax deduction for charitable contributions thus both increases the amount of funds going to these types of activities (correcting a suboptimal level of funding) and imposes costs on those uncharitable individuals (making them involuntary contributors to these causes).

Support for tax subsidies for charitable contributions also rests on potential failures that may be inherent in the government decision-making process. If we leave all spending decisions to the political process, the level of collective goods and services would be decided by majority rule. The tax subsidy for charitable contributions allows, at least for certain types of goods and services, the preferences of a minority of voters who have a greater taste for certain collective activities to receive government support, as long as they are willing also to pay for them.[54] This decentralized approach allows for greater diversity

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[52] Pozen, D.E., 2006. Remapping the Charitable Deduction. *Connecticut Law Review*, 39(2), 531-602 at 573.
[53] *See* Gergen, *supra* note __, at 1396-1406; *see also* Boadway, R. and Wildasin, D., 1984. *Public Sector Economics*. 2nd ed. Boston: Little, Brown and Company. Market failures could also result from other causes, such as information asymmetries.
[54] Weisbrod, B.A., 1972. *Toward a Theory of the Voluntary Non-Profit Sector in a Three-Sector Economy*. Madison, W.I.: University of Wisconsin; Levmore, S., 1998. Taxes as Ballots. *University of Chicago Law Review*, 65(2), 387-431.

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and innovation, among other benefits.[55] Under this view, the greater the heterogeneity of preferences for collective goods, the stronger the case for tax subsidies for charitable contributions.

For our purposes, it is remarkable how little guidance these subsidy theories provide on such basic questions as which types of activities should qualify for favorable tax treatment and whether to extend tax deductions for foreign charitable activities of foreign charities. While the subsidy theories may provide general support for the government matching of private contributions, it does not tell us which types of activities to support, how much support to provide, or in which countries to provide support. Attempts to rank charities as to their relative worthiness based on their purpose and effectiveness of performance face substantial obstacles.[56] These challenges are perhaps unsurprising given both the difficulty of achieving political consensus on what activities are more or less worthy and of assessing the relative efficiency and effectiveness of performance.

Rather than rely on academic theories, we can view charitable tax subsides as a necessary part of the bargain to encourage charitable activities. The current tax regime reflects a series of trade-offs that occurred in the U.S. legislative and administrative process that result in a robust charitable sector.

The first trade-off focuses on the types of activities that merit tax subsidies. Policy makers can choose between a relatively narrow group of activities to support (for example, limiting to organizations that help the poor or prevent disease) or a more expansive approach (adopting a broad definition of what is "charitable"). The narrow approach reflects a policy decision that some types of charitable activities deserve government support more than others. In contrast, the expansive approach gives donors greater choice on how to spend their funds (and matching government funds) that likely results in more diverse and innovative charitable sector. In taking the broad approach, Congress was willing to use tax subsidies to support many different types of charitable activities, recognizing that some of the activities that receive support are of questionable "worthiness."[57]

A second trade-off concerns the level of review in granting tax-exempt status and monitoring charitable activity. Here, governments can choose between an aggressive approach that allocates resources to substantive reviews of applications for tax-exempt status and to monitoring entities to ensure they are fulfilling their charitable mission, and a more narrow approach that relies on a limited review of applications for tax-exempt status and relies heavily on reporting to monitor activity. In taking the narrow approach, Congress

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[55] *Id.*

[56] Schmalbeck, R., 2010. Reforming Uneven Subsidies in the Charitable Sector. *Exempt Organization Tax Review*, 66(3), 237-251.

[57] Fleischer, M., 2009. *Theorizing the Charitable Tax Subsidies: The Role of Distributive Justice*. Illinois Law and Economics Research Paper Series No. LE09-006. Champaign, I.L.: University of Illinois College of Law. Available from: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1348772 [Accessed 3 November 2020].

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is encouraging the growth of the charitable sector recognizing that a potential for abuse exists.

A third trade-off focuses on the design of tax incentives. Generally, the more generous incentives are, the higher the amounts of charitable contributions will be.[58] For example, favorable tax treatment for contributions of appreciated property will result in greater contributions, albeit at a cost of substantial lost tax revenues. Again, Congress has adopted a menu of tax incentives (more than just the charitable deduction under the personal income tax) that has resulted in a large and diverse charitable sector. If Congress scales back on favorable tax treatment, then the growth of the charitable sector will slow.

The important insight is that these (and other) trade-offs were instrumental in adopting and shaping tax subsidies for charitable activities. It may be that Congress focused on both domestic and foreign charitable activities and charities in making decisions as to the scope of charitable activity, the level of government supervision, and the design of tax subsidies (and revenue costs). However, it is also possible Congress made these choices focusing primarily on domestic charitable activities and charities. It is likely that for each of these three trade-offs, different considerations may apply for domestic charitable activities and domestic charities as compared to foreign charitable activities and foreign charities. This may change the focus from the binary question of whether or not to extend the current charitable regime to foreign charitable activities and charities to how might the tax regime differ for foreign charitable activities and charities.

B. Optimal Level of Charitable Tax Subsidies.

The nonprofit sector in the U.S. consists of 1.5 million charitable entities, with assets of about $4 trillion ($2.5 trillion in net assets), and total revenues of $2.1 trillion (about 11% of GDP).[59] The sheer number and size of charitable organizations raises the question of whether the nonprofit sector in the US is too big or too small. I have no idea—but I am confident that bigger is not necessarily better.

What would we need to know to answer this question? To start we would require information about the charitable organizations and the different types of activities they are engaged in. We would then have to engage in the messy process of determining the societal benefits generated by the charitable sector, a process that requires making value judgments of the relative merits of different types of charitable activities (soup kitchens versus operas). While at one time the IRS adopted a rather narrow view of what activities

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[58] The level of charitable giving is influenced by price effects (changes in the after-tax cost of giving from changes in tax rates or the design of tax subsidies) and by income effects that affect the income available for charitable donations (economic growth, inflation, and tax rates). These effects may work in opposite directions. Clotfleter, C.T. and Salamon, L.M., 1982. The Impact of the 1981 Tax Act on Individual Charitable Giving. *National Tax Journal*, 32(2), 171-187.

[59] Gravelle, J.G., Marples, D.J., and Sherlock, M.F., 2020. *Tax Issues Relating to Charitable Contributions and Organizations*. Washington, D.C.: Congressional Research Service, R45922 at 14. Available from: https://fas.org/sgp/crs/misc/R45922.pdf [Accessed 21 September 2020]; Urban Institute, *supra* note 1.

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constitute charitable activities,[60] the current approach provides for tax subsidies for a "kaleidoscope" array of organization that often have little to do with common perceptions of charitable activity, such as poverty-reduction, education, and health services.[61]

One's view of the optimal size of the charitable sector is likely colored by confidence in the approval process for tax-exempt and nonprofit status and the success of the IRS and state governments in monitoring charitable activities. Here, much is lacking. The IRS and state government approve almost all applications for tax-exempt and non-profit status and their ability to monitor the activities of over 1.5 million entities is extremely limited.[62] With some high-profile exceptions,[63] because of either a lack of political will or resources, there is remarkably little oversight of the charitable sector, especially in light of its size and importance.

Also important in thinking about the optimal size of the charitable sector is the relative efficiency of charities in using their assets to provide goods and services. Unlike the for-profit sector, for many charitable organizations there is relatively little "market discipline" by consumers. Underperforming charitable organizations seldom go out of business. While organizations such as the Charity Navigator[64] and Charity Watch[65] provide information about the financial health, accounting and transparency, and fund-raising practices of different charitable organizations, these reviews focus more on financial management of the charities rather than on the effective use of their assets to fulfill their charitable purposes.

Attempts to rank charities by the effectiveness in providing societal benefits (for example, lives saved or lives improved per dollar spent) requires assessments of the relative marginal benefits from new charitable contributions as well as value judgements as to the types of

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[60] Colombo, J.D., 2009. The Role of Redistribution to the Poor in Federal Tax Exemption for Charities. *Shades of Virtue: Measuring the Comparative Worthiness of Charities*, 29-30 October 2009 New York. National Center on Law and Philanthropy at __. Available from: https://ncpl.law.nyu.edu/wp-content/uploads/resources/Conf2009JColomboPaper.pdf [Accessed 2 November 2020]; Schmalbeck, R., 2009. Reforming the Charitable Sector to Account for Relative Worthiness? *Shades of Virtue: Measuring the Comparative Worthiness of Charities*, 29-30 October 2009 New York. National Center on Law and Philanthropy. Available from: https://ncpl.law.nyu.edu/wp-content/uploads/resources/Conf2009RSchmalbeckPaper.pdf [Accessed 8 October 2020] .

[61] Reich, R., 2018. *Just Giving: Why Philanthropy is Failing Democracy and How It Can Do Better*. Princeton, NJ: Princeton University Press at 84.

[62] *Id*. at __.

[63] *See, for example,* the N.Y. State Attorney General investigation of Trump Foundation. New York State Attorney General, 2019. *Donald J. Trump Pays Court-Ordered $2 Million for Illegally Using Trump Foundation Funds* [press release]. 10 December 2019. Available from: https://ag.ny.gov/press-release/2019/donald-j-trump-pays-court-ordered-2-million-illegally-using-trump-foundation [Accessed 6 October 2020]

[64] Charity Navigator, 2020. *Charity Navigator's Methodology* [online]. Available from: https://www.charitynavigator.org/index.cfm?bay=content.view&cpid=5593#rating [Accessed 6 October 2020].

[65] Charity Watch, 2021. *Our Charity Rating Process* [online]. Available from: https://www.charitywatch.org/our-charity-rating-process [Accessed 10 January 2021].

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projects that merit support. Organizations such as GiveWell (a U.S. public charity) provide guidance to potential donors by identifying high-impact giving opportunities.[66] GiveWell has developed a cost-effectiveness algorithm that allows the organization to compare charities engaged in similar activities as well as across different charitable activities.[67]

The non-profit sector also faces major corporate governance challenges. In the for-profit sector, shareholders play a role in monitoring the behavior of managers and directors, and directors (with varying degrees of success) monitor the behavior of managers. Many charitable organizations (especially those with a large number of donors contributing small amounts) lack mechanisms for controlling the actions of managers and the board of directors.[68] A survey of corporate governance practices in U.S. non-profits highlights their failure to adopt measures that would improve accounting and transparency.[69] These challenges have led to calls to reduce the size of the board of directors of large nonprofit organizations as well proposals to bifurcate boards (with one board focusing on fund-raising and the other board with governance responsibility).[70] The American Red Cross[71] and FIFA[72] offer two examples of high-profile corporate governance failures that resulted in less effective performance of charitable activities and misappropriation of charitable funds.

The question of the optimal level of charitable tax subsidies is intertwined with the question of the optimal relative split between the size of the public sector, private sector, and the charitable sector. Whether governments should provide charitable tax subsidies depends on the relative marginal costs and marginal benefits of those subsidies. Determining costs

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[66] *GiveWell* [online]. Available from: https://www.givewell.org/ [Accessed 6 October 2020].

[67] GiveWell's cost-effectiveness formula provides for GiveWell (and other donors) to make subjective determinations of the relative worthiness of different charitable activities. Their list of top charities reflects a heavy weighting towards disease prevention in low-income countries. GiveWell, 2020. *Top Charities* [online]. Available from: https://www.givewell.org/charities/top-charities?utm_expid=.uFVmrEFITdeqKbE25XDcxA.0&utm_referrer=https%3A%2F%2Fwww.givewell.org%2F [Accessed 6 October 2020].

[68] Brody, E., 2007. The Board of Nonprofit Organizations: Puzzling Through the Gaps Between Law and Practice. *Fordham Law Review*, 76(2), 521-566.

[69] Ostrower, F., 2007. *Nonprofit Governance in the United States: Findings on Performance and Accountability from the First National Representative Study*. Washington, D.C.: Urban Institute. Available from: https://www.urban.org/sites/default/files/publication/46516/411479-Nonprofit-Governance-in-the-United-States.PDF [Accessed 21 September 2020]. *See also* Donatiello, N., Larcker, D.F., and Tayan, B., 2015. *What Can For-Profit and Nonprofit Boards Learn from Each Other About Improving Governance?*. Stanford Closer Look Series No. CGRP49. Stanford, C.A.: Rock Center for Corporate Governance at Stanford University. Available from: https://www.gsb.stanford.edu/sites/default/files/publication-pdf/cgri-closer-look-49-profit-nonprofit-learn.pdf [Accessed 6 October 2020].

[70] Klausner, M. and Small, J., 2005. Failure to Govern? The Disconnect Between Theory and Reality in Nonprofit Boards, and How to Fix It. *Stanford Social Innovation Review*, 3(1), 93-100.

[71] American Red Cross Board of Governors, 2006. *American Red Cross Governance for the 21st Century*. Washington, D.C.: American Red Cross. Available from: https://www.redcross.org/content/dam/redcross/atg/PDF_s/Governance/BOGGovernanceReport.pdf [Accessed 21 September 2020].

[72] Besinger, K., 2018. *Red Card: FIFA and the Fall of the Most Powerful Men in Sports*. New York: Simon & Schuster, Inc.

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and benefits requires some prediction of what the counterfactual would be—what would the charitable sector look like in a world without tax subsidies?

Countries differ in the relative split between goods and services provided by the public sector, private sector, and charitable sector.[73] One, two, or three sectors can provide health care, primary, secondary, and university education, or poverty relief programs. Not surprisingly, countries with more comprehensive and successful government-provided health, education, or poverty relief programs will likely have a smaller nonprofit sector than countries with less successful or less comprehensive government programs.

One explanation of why Americans are more generous in making contributions to support charitable activities than residents of other countries is because of a relatively low level of government spending (or effectiveness) for these activities. In the cross-border context, large charitable contributions funding foreign charitable activities could compensate for relatively low levels of U.S.-government provided foreign assistance. The key insight is that individuals can "purchase" these types of goods and services by either paying taxes or making charitable contributions, but they direct the "purchase" only by charitable contributions, while majority rules for taxes.

Countries preferring a larger charitable sector will likely provide greater charitable tax subsidies than countries preferring a smaller charitable sector. But while the total level of government support for charitable activities (either through direct government expenditures or charitable tax subsidies) may be relatively similar among countries, the key difference is who dictates how the funds are spent.

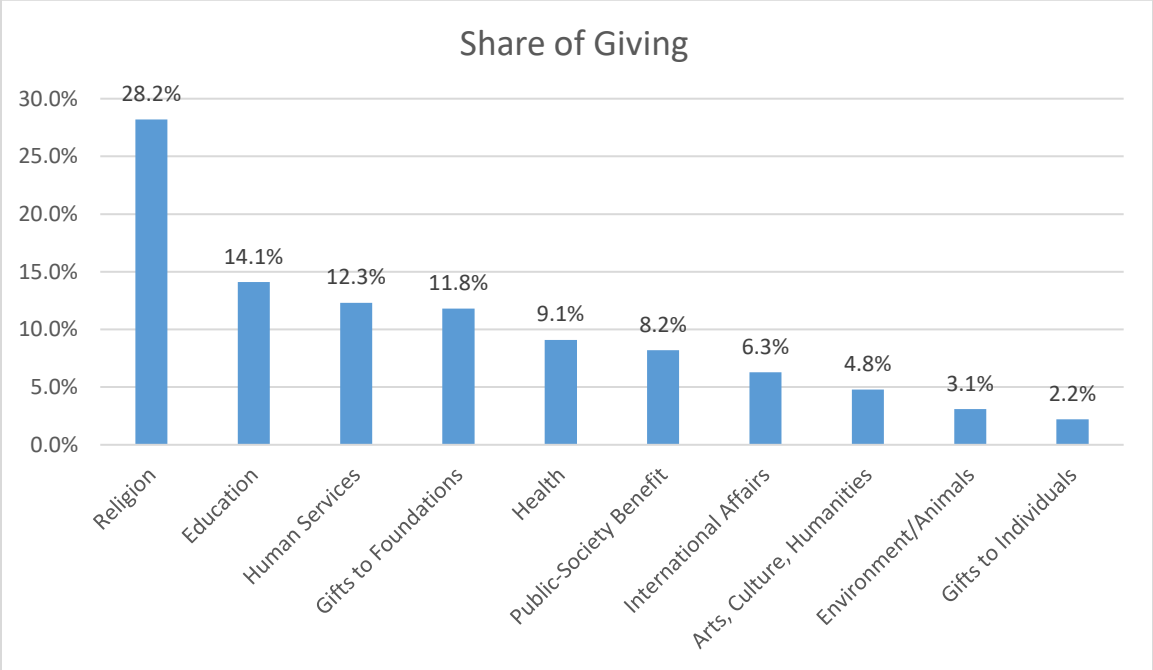
Who benefits from charitable tax subsidies? One answer is the charitable organizations. These organizations now have greater resources because of the tax benefits. We first need to see which types of charities receive substantial contributions.

Figure 1 sets forth the choices made by U.S. donors in their charitable giving in 2019. Similar to other countries, religious organizations receive the largest share of donations. Contributions to international organizations and to arts, culture, and humanities organizations are a lower percentage of total giving, though still substantial in amounts of donations.

[73] Challenges exist in comparing charitable sectors across countries because of differences in the size and composition of government social spending programs. One can divide countries into four categories of states (liberal states, social-democratic states, corporatist states, and statist states) depending on the relative size of the welfare state and charitable sector. OECD, *supra* note _ at 12.

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Figure 1. Shares of Charitable Giving by Type of Recipient (2019)



Source: Gravelle *et al.*, *Tax Issues Relating to Charitable Contributions and Organizations*; The Center on Philanthropy at Indiana University, *Giving USA 2020.*

We then need to determine who benefits from the charitable activity. Beneficiaries depend on the type of charitable activity—with gifts to poverty-reduction organizations helping low-income individuals, gifts to religious organizations primarily benefitting members of the congregation, and gifts to arts organizations and prestigious private schools skewed towards the wealthy.

Table 1. highlights how charitable giving varies by income levels.

Table 1. Household Giving, by Income and Charity Type. ($ in billions)

Household Income	Religion	Combined	Help meet basic needs	Health	Education	Arts	Other	Total
<$100,000	59.96	7.70	9.34	3.06	2.69	1.01	6.16	89.92
$100,000 to $200,000	11.39	2.16	2.46	1.12	1.14	.44	1.17	19.88
$200,000 to $1 million	21.01	10.19	5.30	4.81	29.15	13.57	7.45	91.48
$1 million or more	8.64	2.06	1.93	12.97	12.94	7.88	4.85	51.27
Total	101.00	22.11	19.03	21.96	45.92	22.90	19.63	252.55

Source: The Center on Philanthropy at Indiana University, 2007. *Patterns of Household Charitable Giving by Income Group, 2005*. Bloomington, I.N.: The Center on Philanthropy at Indiana University at 12.

Because the beneficiaries of tax subsidies vary greatly by income level, tax subsidies are going disproportionately to charities supported by the wealthy rather than charities favored

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by those at the bottom and middle of the income distribution. For all charitable giving, no more than one-third of the contributions are made to organizations that assist the poor. In contrast, for donors with income greater than $1 million, the share going to organizations that assist the poor is no more than one-fifth of total contributions.[74]

Another potential beneficiary of charitable tax subsidies is the donor. Again, we need to know the counterfactual—what would the amount of contribution be if there was no tax subsidy? If a donor who makes a $1 million contribution would have contributed the same amount without a tax subsidy then the donor is better off by the amount of the tax subsidy (and the financial position of the charity is not changed). The result is simply a tax reduction without any increase in charitable funding. If the amount of the contribution would be less if no tax subsidy (but not reduced by the full amount of the tax benefit) then the donor and the charity would share the tax subsidy.

As discussed earlier, only about 10% of U.S. taxpayers can take advantage of charitable deduction under the personal income tax (and only about 4,000 individuals who died in 2018 left estates large enough to require filing an estate tax return and to claim charitable deductions under the estate tax).[75] Figure 2 below sets forth for different income levels the relative amount of the contribution supported by tax subsidies. Much greater tax subsidies are provided for contributions made by those at the top of the income distribution than contributions made by middle- or low-income donors.

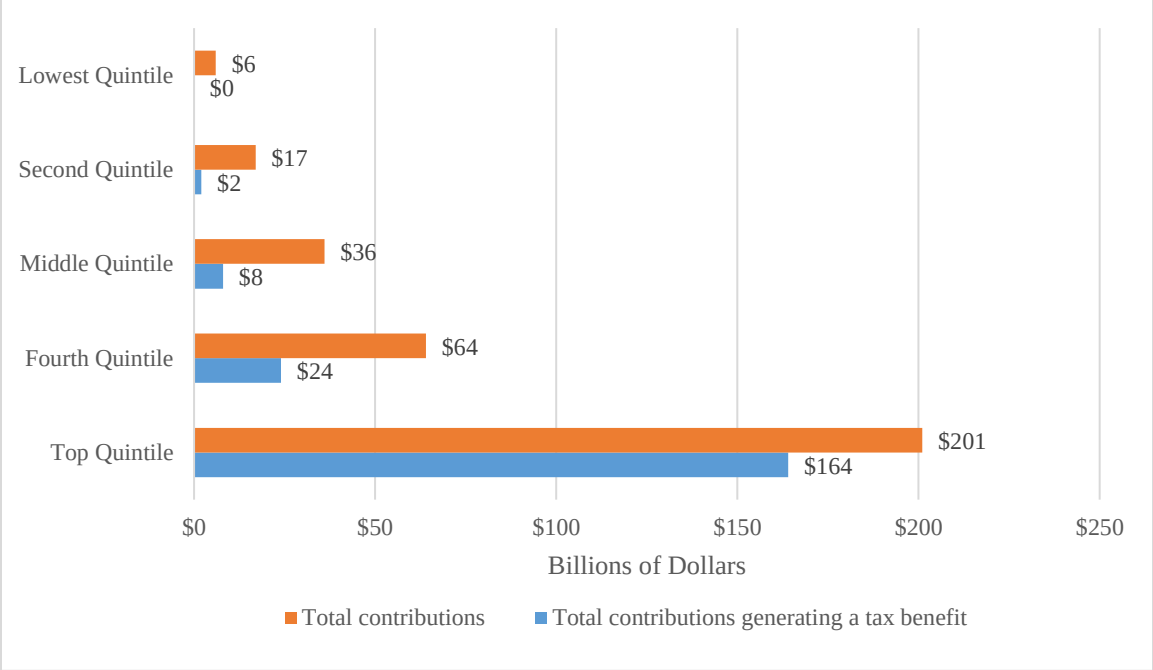
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[74] Reich, *supra* note __at 88-89.

[75] Tax Policy Center, 2020. Key Elements of the U.S. Tax System: Who Pays the Estate Tax? [online]. *In: Tax Policy Briefing Book.* Washington, D.C.: Urban-Brookings Tax Policy Center. Available from: https://www.taxpolicycenter.org/briefing-book/who-pays-estate-tax [Accessed 11 November 2020]. Covid 19 relief legislation provides non-itemizing taxpayers a temporary $300 deduction for cash contribution made in 2020.

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Figure 2: Tax Benefits for Contributions by Income Group (2020)



Source: McClelland, R., Steuerle, E., Lu, C., and Boddupalli, A., 2019. *Tax Incentives for Charitable Contributions*. Washington, D.C.: Urban-Brookings Tax Policy Center.

Given how the current U.S. tax regime "matches" charitable contributions, it is not surprising that the top quintile captures almost all of the tax benefits, with over half going to the top 1%. Table 2 provides an estimate of the distribution of tax benefits for charitable deduction under the personal income tax system.

Table 2: Distribution of Charitable Deduction under the Federal Income Tax (2020)

Expanded Cash Income Percentile	Total Contributions ($ billions)	Share of Total Tax Benefit (%)	Marginal Tax Benefit Per $100 of Contributions ($)	Share of Tax Units with Benefit (%)
Lowest Quintile	$6.3	*	$0.1	0.1%
Second Quintile	$16.9	0.3%	$1.4	1.4%
Middle Quintile	$36.1	1.7%	$3.2	5.6%
Fourth Quintile	$63.9	6.5%	$6.6	14.1%
Top Quintile	$200.9	95.1%	$21.8	36.3%
All	$324.4	100.0%	$15.3	8.9%
Breakdown of Top Quintile				
80th-90th Percentile	$43.8	7.6%	$11.4	25.0%
90th-95th Percentile	$30.4	8.2%	$15.5	37.4%
95th-99th Percentile	$39.6	17.6%	$22.5	54.8%
Top 1 Percent	$87.1	58.1%	$29.0	79.7%
Top 0.1 Percent	$53.0	35.2%	$28.0	89.9%

Source: McClelland, R., Steuerle, E., Lu, C., and Boddupalli, A., 2019. *Tax Incentives for Charitable Contributions*. Washington, D.C.: Urban-Brookings Tax Policy Center.

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What about the costs of the tax subsidies? The economic consequences of providing subsidies through the tax system depends on who bears the burden of reduced tax revenues associated with charitable tax subsidies. Here are some alternatives. First, the government could compensate for the lost revenue from charitable tax subsidies by adopting revenue raising income tax provisions (for example through higher tax rates). Second, government could recoup the lost revenue by increases in taxes other than the income tax. Finally, the lost revenue from charitable tax subsidies could simply result in reduced government spending (some of which might be offset by the charitable activities).

For each alternative, a different class of individuals bears the consequences of providing tax subsidies. For example, if governments recaptured lost revenue under the income tax system, the burden will fall primarily on wealthy individuals who are not charitable. In the U.S., the income tax burden falls primarily on high-income taxpayers. For the 2017 tax year, the top 1% received 21% of total adjusted gross income and paid 38.5% of the Federal income taxes. The top 10% received about 48% of total income and paid about 70% of total Federal income tax. In contrast, the bottom 50% received only about 11% of total income and paid about 3% of total Federal income taxes. The poor are not subsidizing the charitable activities of the billionaires who signed the Giving Pledge, it is other millionaires and billionaires.

In contrast, if governments recoup revenue from other parts of the tax system, then the burden will fall on all taxpayers. Here, the distribution of the total tax burden falls more evenly across the population. When we focus on all Federal taxes, the share of total taxes of the top 1% falls to about 25% and for the top 10% the share is about 54%.[76]

Finally, if governments choose to reduce government spending then the burden falls on those individuals who would have received those goods and services. Here the economic cost of charitable tax subsidies is not limited to lost revenue, it also includes the opportunity costs associated with reduced government spending (which may or may not be more socially useful than privately directed charitable activity).

C. Funding and Allocation Alternatives for Charitable Activities: Why Pay Lobbyists to Influence Government Spending?

We could, but do not, separate the decision to provide federal funds for charitable activities from the decision of who gets to decide how federal funds are spent. The framework below sets forth different combinations of funding and allocation decisions that reflect the public and private nature of using tax benefits to subsidize charitable activities.[77]

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[76] Congressional Budget Office, 2019. *Projected Changes in the Distribution of Household Income, 2016 to 2021*. Washington, D.C.: U.S. Congress. Available from: https://www.cbo.gov/publication/55941 [Accessed 21 September 2020].

[77] This framework was suggested by Mitchell Kane in his Comment on Zolt, E.M., 2009. 'Tax Aspects of Private Development Assistance' [presentation]. NYU School of Law Rubin International Law Symposium, 4 December 2009 (on file with the Author).

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Figure 3. Allocation and Funding Alternatives

		Funding Alternatives	
		Private Funds	*Public Funds*
Allocation Alternatives	*Private Actors*	Unmatched portion of charitable contributions	Matching portion of charitable contributions
	Public Actors	Government regulation (incentives and restrictions on the use of private funds)	Direct government programs (spending authorized by elected representatives)

The upper left box reflects the use by individuals or corporations of their own funds to support activities that they choose. This is the after-tax cost of charitable contributions. For example, if an individual is subject to tax at the 37% marginal tax bracket and makes a $1,000 contribution, the value of the income tax deduction is $370, and the after-tax cost would be $630. Donors can further reduce the after-tax cost of making charitable contribution by taking advantage of tax subsidies afforded contributions of appreciated property as well as other income, gift and estate tax savings. For those individuals who receive no tax benefits for their contributions, either because they do not itemize deductions or have no tax liability, the full amount of their contribution would be included in this box.

The upper right box reflects the tax benefits associated with the contribution. Here private actors determine how public funds are allocated. Why pay lobbyists to persuade members of Congress on spending priorities when I can get my own private earmark to support medical services to combat cholera in Haiti simply by writing a check to the U.S. affiliate of Doctors Without Borders (Médécins Sans Frontières). Here donors can direct government spending while bypassing majority approval. Minority preferences dictate government spending patterns.[78]

The bottom left box reflects government regulation that influences the use of private funds for charitable purposes. This includes both incentives for funding certain types of activities and organizations and disincentives and prohibitions against certain types of activities, such as expenditures that may jeopardize an organization's tax-exempt status or that may result in excise taxes for private foundations.[79] In a post September 11, 2001 world, it also

[78] Benshalom, I., 2009. The Dual Subsidy Theory of Charitable Deductions. *Indiana Law Journal*, 84(4), 1047-1098; Madoff, R.D., 2010. What Leona Helmsley Can Teach Us About the Charitable Deduction. *Chicago-Kent Law Review*, 85(3), 957-974.

[79] *See* Sanders, M.I. and Roady, C. *Private Expenditures – Tax Expenditures (Sec. 4945)*. Bloomberg Tax Portfolio No. 474. Bloomberg Tax and Accounting. Available from:

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include requirements for charitable organizations to prevent diversion of charitable assets for illicit purposes (money laundering and counter-terrorist financing).

Finally, the bottom right box reflects public actors spending public funds. Here taxpayers are subject to the whims of the majority (through their elected representative) who dictate how revenues are spent (including funds for many of the same types of activities supported by charitable tax subsidies). Congress can decide directly how to spend funds from general tax revenues or Congress can delegate spending decisions to state and local governments, to government agencies, or to some band of experts, such as the governing boards of the National Science Foundation or the National Endowment of the Arts. Important for our purposes, this bottom right box includes amounts provided to U.S. Agency for International Development (US AID). In 2019, US AID provided about $2.7 billion in grants for U.S.-based charities for foreign humanitarian and development assistance.[80]

Viewing the charitable deduction (and other income and estate tax subsidies) as a matching grant program provides a lens to view charitable tax subsidies under different academic theories. As discussed earlier, we could allow charitable tax deductions because amounts contributed should not be included in an individual's tax base. Under these "base defining" theories, the existence of a Federal matching program does not change the donor's tax base but does have tax revenue consequences.

Subsidizing charitable activity could also be justified because of market or government failure. Tax subsidies allow the minority to support activities that might be underprovided by the majority or under a "pluralistic" view that values greater participation, innovation, and supervision by donors to charitable activities. Under these theories, who gets to take advantage of tax subsidies and the relative split between donors and governments matter. The attractiveness of tax benefits for domestic or foreign charitable activities and charities may depend on the scope and degree of the subsidy, as well as the relative cost sharing between donors and government.

Here are a couple of alternatives for tax regimes that highlight the matching component of charitable tax subsidies. First, consider a tax regime with a relatively low top marginal income tax rate (say 20% tax rate) and a very large percentage of the population pays income taxes and is able to benefit (if they desire) from the charitable deduction. Here, donors are bearing 80% of the cost (and reduced tax revenues cover the other 20%) and a

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https://pro.bloombergtax.com/portfolio/private-foundations-taxable-expenditures-sec-4945-portfolio-474/ [Accessed 6 October 2020]; I.R.C. § 4945 (2010).

[80] Calculated based on data published by USASpending.gov on awards made by US AID in 2019. This calculation only includes payments of new and continuing grant awards made to entities that were confirmed to be US-based NGOs for charitable projects in foreign locations. USASpending.gov, 2020. *Custom Award Data*. Available from: https://www.usaspending.gov/download_center/custom_award_data [Accessed 10 January 2021]. For a review of U.S foreign assistance activities, *see* Lawson, M. and Morgenstern, E.M., 2020. Foreign Aid: An Introduction to U.S. Programs and Policy. Washington, D.C.: Congressional Research Service, R40213. Available from: https://crsreports.congress.gov/product/pdf/R/R40213 [Accessed 11 November 2020].

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large part of the population could participate in the matching grant program. For those in favor of using tax subsidies to support domestic or foreign charitable activities, the combination of donors providing the lion's share of the funding and the possible high levels of citizen participation provide substantial support for the tax subsidies.

In contrast, consider a tax regime with a top marginal tax rate of 80% and only individuals subject to the top rate can claim charitable deductions. Here donors are contributing a relatively small amount of the costs of the charitable activities (20%), with the rest shifted to the government in the form of reduced tax revenues. Wealthy donors are able to dictate government spending even though their out-of-pocket costs are relatively low.

D. Whose Money Is It (and Should It Matter)?

While the U.S. top marginal income tax rate currently is 37%[81] (much less than the 90% tax rate of many decades ago), total current and future tax benefits may increase the relative split between donors and government to much higher levels (with the cost to the government much closer to or exceeding 80% rather than the 20% of the example above). Even where the income tax benefits from charitable tax deductions are relatively low, other income and estate tax savings (both Federal and state) could substantially alter the relative contributions between donors and governments.

Let's start with what is one of the strongest cases for tax subsidies for charitable activities: The Bill and Melinda Gates Foundation.[82] The Gates Foundation allocates roughly 60% of its spending on foreign charitable activities and 40% on domestic charitable activities. An OECD survey of philanthropic giving by foundations to developing countries found that the Gates Foundation provided half of total giving.[83] By any formulation of "worthy" charitable activities, the types of foreign activities supported by the Gates Foundation easily qualify. The Gates Foundation funding generates substantial benefits in foreign countries but also generates positive externalities across borders. The foreign projects supported by the Gates Foundation likely address both political and market failures in foreign countries and are designed and monitored by talented and dedicated employees. The Gates Foundation provides a high level of transparency for grant and financial information to allow for a review of their activities.

What are the tax revenue consequences for Bill Gates and the Gates Foundation? First, Bill Gates gets an income tax deduction for his contribution of Microsoft stock to the Gates Foundation. Let's assume that Bill Gates contributes $40 billion of Microsoft stock to the Gates Foundation and that he is subject to income tax at a 37% rate, and in the year of the

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[81] The top marginal tax rate exceeds 37% when social insurance taxes and state and local income taxes are included.

[82] The Gates Foundation consists of two related entities: The Bill and Melinda Gates Foundation that has responsibility for the operations of the foundation and the Bill and Melinda Gates Foundation Trust that holds and manages the donated investment assets from Bill and Melinda Gates and Warren Buffett. For this discussion, the reference to the Bill and Melinda Gates Foundation refers to the combined entities.

[83] OECD, *supra* note _ at 12.

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contribution has $50 million in adjusted gross income. What is the value of the charitable deduction under the personal income tax? As noted in the Gates Foundation 2019 Annual Report, the income tax benefits are relatively insignificant.[84] If Gates were able to use fully the charitable deduction to reduce his taxable income for the year to zero (with large carryforwards), the potential charitable tax benefit would be $18.5 million ($50 million multiplied by 37% = $18.5 million). The contribution reduces U.S. tax revenues by $18.5 million.

However, limitations apply. U.S. tax law provides for less generous rules for contributions to private foundations. Applying the 20% adjusted gross income limitation for contributions of property to private foundations reduces the amount of the charitable deduction to $10 million dollars ($50 million multiplied by 20%) and the amount of the tax savings to about $3.7 million ($10 million multiplied by 37%). The amount of lost revenue to the U.S. government from the charitable deduction (even if Gates staggered his stock contributions over several years and he took advantage of charitable carryforwards) is trivial compared to the size of the $40 billion contribution.[85]

But this is not the end of the story. By funding the Gates Foundation with appreciated property rather than cash, Bill Gates permanently avoids any tax on pre-transfer appreciation of Microsoft stock. What would the tax liability be if Bill Gates sold the stock (either to fund the Gates Foundation or other purposes)? If we assume a tax basis of 5% of the value of the stock ($2 billion), the gain recognized by Bill Gates is $38 billion. Assuming current capital gains rates of 23.8%, the tax liability of the sale would be roughly $9 billion, leaving Bill Gates with $31 billion in after-tax proceeds. While Bill Gates' state of residence (Washington) has no personal income tax, the effective capital gains tax rate

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[84] The Bill and Melinda Gates Foundation's 2019 Annual Report has a section featuring Frequently Asked Questions. Here is a question and answer related to tax benefits for contributions to the foundation:

> Q: Do Bill and Melinda get tax breaks for their donation to the foundation?
>
> A: Many individuals enjoy tax benefits because of making charitable contributions. The amount of tax savings depends on both the size of the charitable contribution and the person's annual income.
>
> Bill and Melinda have been exceptionally generous in making contributions to the foundation, donating sums much larger than their annual income. As a result, the tax savings they receive from these contributions represent a very small percentage of the contributions.

Bill & Melinda Gates Foundation, 2020. *Annual Report 2019* [online]. Seattle: Bill & Melinda Gates Foundation. Available from: https://www.gatesfoundation.org/Who-We-Are/Resources-and-Media/Annual-Reports/Annual-Report-2019 [Accessed 21 September 2020].

[85] The relative unimportance of the charitable income tax deduction is not uncommon for many ultra-wealthy donors. For example, for 2015, Warren Buffett had adjusted gross income of $11,565,931 and claimed charitable deductions of $3,469,179. Buffett's charitable contributions for 2015 were about $2.8 billion. Because of Section 170 limitations, the income tax benefits were about 0.12% of total contributions ($3,469,179 divided by $2.8 billion). Reuters Staff, 2016. Buffet hits back at Trump over tax comments [online]. *Reuters*. Available from: https://www.reuters.com/article/us-usa-election-buffett/buffett-hits-back-at-trump-over-tax-comments-idUSKCN12A1Z0.

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in many states are much higher. If Bill Gates gave up rain in Seattle for sunshine in Los Angeles, he would face a potential capital gains tax rate of over 37%.

Of course, Bill Gates has techniques to monetize the $40 billion of Microsoft stock without incurring tax liability. For example, he could borrow against the stock and engage in hedging transactions to minimize (but not completely eliminate) the potential decline in Microsoft stock. He could then hold the stock until death and under current U.S. tax law avoid any tax on pre-death appreciation of the Microsoft stock. But he has a long time to wait. Using IRS guidance on life expectancy, Bill Gates at age 64 has life expectancy of 23.6 years (his friend and charitable partner, Warren Buffett, is 90 years old and has an IRS-predicted life expectancy of 5.7 years).

Bill Gates' generosity has additional tax revenue consequences to the U.S. government. Gates has irrevocably moved $40 billion of his assets (and additional billions from Warren Buffett and others) from the taxable to the tax-exempt sector. In the 2019 Annual Report, the Gates Foundation reported $6 billion of investment income. One approach in determining the value of the tax-exemption is the amount of potential tax liability on the $6 billion in excess of any tax imposed on the investment income of private foundations. For current tax years, private foundations pay a tax on investment income of 1.39%. If the $6 billion of investment income were currently taxable and subject to tax at 21% (the corporate tax rate) or the 23.8% rate applicable to dividends and capital gains of individuals, the lost tax revenue to the U.S. government would be roughly $1.4 billion per year.[86] This tax subsidy will continue as long as the Gates Foundation has substantial investment assets.

Finally, at time of death, the size of Bill Gates' estate is likely smaller because of the $40 billion contribution to the Gates Foundation (and other contributions to the Gates Foundation and other charities). The amount of the reduction in the size of the taxable estate from the contribution of Microsoft stock to the Gates Foundation as well as the amount of the tax benefits depends on many factors, including assumptions as to how the assets and proceeds would have been used, how they would have appreciated, the life expectancies of Bill and Melinda Gates, and what other tax minimization strategies Bill and Melinda Gates might exploit. Here are some plausible estimates. One approach just focuses on the $40 billion contribution and assumes the taxable estate shrinks by that amount. Current estate tax rates are 40%, resulting in a tax benefit of $16 billion. Alternatively, we could assume that Gates retained the $40 billion in Microsoft stock until death, in which case the value (and resulting tax benefit) could be less (if Microsoft stock declined in value or Bill and Melinda Gates engaged in high levels of consumption that

[86] A recent report by the Congressional Research Service examines the tax revenue consequences of the tax exemption for investment income. Using data from the IRS, they find that for 2016 tax year, charities had $36.8 billion in investment income, $45.1 billion in net capital gains, $3.9 billion in net rental income and $3.5 billion in royalties. If this income were subject to then 35% corporate tax rate, the U.S. government would have received $31.3 billion of additional tax revenue. Gravelle *et al.*, supra note __.

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generated no residual value) or substantially more (if Microsoft continued to appreciate in value).

We are back to the original question of funding and allocation alternatives for charitable activities: Who should decide how to spend the funds resulting from charitable tax subsidies? Should the Gates Foundation have sole discretion in choosing which diseases to combat and which African countries deserve financial support?

This is no correct or easy answer. One view of Bill and Melinda Gates' funding of the Gates Foundation is resoundingly positive. One can make a strong case that the Gates Foundation is funding exactly the types of foreign charitable activities that merit government subsidies, especially given the cross-border challenges for disease prevention. Organizations like the Gates Foundation may be better positioned to design and monitor these types of programs than government agencies (such as US AID) or international organizations. Bill and Melinda Gates could simply have spent the funds contributed to the Gates Foundation on houses, artwork, and Stave puzzles[87] or made additional investments to increase their wealth. Compared to consumption and investment, their philanthropy should be celebrated.[88] And although the lost tax revenue from the counterfactual sale of appreciated Microsoft stock, the loss of investment income for assets transferred to the tax-exempt sector, and the smaller taxable estate on death is substantial, I have little doubt that Bill and Melinda Gates (with the assistance of well-qualified and well-compensated lawyers and accountants) would be able to arrange their finances to reduce greatly any tax liability.

But examining the political and economic consequences of charitable contributions provides a different perspective on philanthropy.[89] Here the desirability of large charitable gifts may depend on the relative size of the tax subsidies for Bill Gates and other mega-donors. If the split is 80% by the donor and 20% by the government then a strong case can be made that the tax subsidies play an important role in encouraging charitable activities (whether domestic or foreign). However, a different answer may result if the size of the aggregate tax subsidies (charitable income tax deduction, no capital gains tax on the contribution of appreciated stock to charity, the tax exemption for investment income, and foregone estate state tax liability) approaches or exceeds 80%.

It is not possible to determine whether the split of the funding of the Gates Foundation between the Gates and the government is closer to 80%/20% or 20%/80% without making various assumptions about Gates' charitable and investment activity and potential tax liability if they did not fund the Gates Foundation. It is also difficult to determine Gates' level of charitable giving in a world where tax subsidies were less generous. But with the current collection of charitable tax subsidies available to many mega-donors, we may well

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[87] *See* Leonard, D., 2020. For Customers Addicted to Stave Puzzles, the Torture is the Point [online]. *Bloomberg Businessweek*, 13 February. Available from: https://www.bloomberg.com/news/features/2020-02-13/for-some-puzzle-obsessives-getting-tormented-is-the-point [Accessed 11 November 2020].

[88] Reich, *supra* note__ at 14-15.

[89] *Id.*

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have reached a "tipping point" whereby these donors decide how to spend potential current and future tax revenues even though their after-tax contribution may be substantially less than the government's share of funding.

If policy makers consider the aggregate tax subsidies too generous, they have several options to scale them back.[90] For example, the tax regime for gifts of appreciated property could be changed to tax donors on any appreciation of the gifted property to charities or to limit the charitable deduction to the tax basis of the property (or just allow charitable contributions only for cash contributions). An Obama-era proposal would cap itemized deductions (including the charitable deductions) at 28% regardless of the taxpayer's tax rate.[91] Congress could change the unlimited estate tax deduction for charitable contributions by imposing limitations based on a dollar amount of contribution or a percentage of the total estate. Congress could also increase existing taxes on investment income of private foundations, increase mandatory distribution rules (and extend distribution requirements to donor-advised funds and public charities), and expand the taxation of investment income of public charity. All these proposed changes will generate additional tax revenue but also will reduce incentives to transfer property to charitable organizations.

Under current law, the charitable income tax deduction plays little or no role for many ultra-wealthy individuals. This partly explains why several ultra-wealthy donors use for-profit limited liability companies rather than tax-exempt private foundations for their philanthropic activities. But with the election of Joe Biden and a Democratic-controlled Congress, this could change. President Joe Biden has proposed increasing the top marginal tax rate and eliminating the rate preference for investment income and capital gains.[92] The Democratic members of the Senate Finance Committee have proposed taxing accrued but not realized gains on certain assets, most notably stock.[93] All these changes would increase

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[90] Joint Committee on Taxation, 2013. *Present Law and Background Relating to the Federal Tax Treatment of Charitable Contributions*. Washington, D.C.: Congress of United States; Colinvaux, R. and Madoff, R.D., 2019. Charitable Tax Reform for the 21st Century, *Tax Notes Federal* 164(12), 1867-1875.

[91] *See* Harris, B.H., *et al.*, 2013. *Analysis of Specific Tax Provisions in President Obama's FY2014 Budget.* Washington, D.C.: Urban-Brookings Tax Policy Center. Available from: https://www.urban.org/sites/default/files/publication/23611/412817-Analysis-of-Specific-Tax-Provisions-in-President-Obama-s-FY--Budget.PDF [Accessed 11 January 2021].

[92] For a summary of former Vice-President Biden's tax proposals, *see* Biden for President, 2020. *A Tale of Two Tax Policies: Trump Rewards Wealth, Biden Rewards Work* [online]. Available from: https://joebiden.com/two-tax-policies/# [Accessed 2 November 2020]; A comprehensive analysis of the economics effects of the Biden tax proposals is set forth in Mermin *et al*., 2020. *An Analysis of Former Vice President Biden's Tax Proposals*. Washington, D.C.: Urban-Brookings Tax Policy Center. Available from: https://www.taxpolicycenter.org/sites/default/files/publication/158624/An_Analysis_of_Former_Vice_President_Bidens_Tax_Proposals_1_2.pdf [Accessed 2 November 2020]. For an overview of proposals to increase taxes on the wealthy, *see* Batchelder, L.L. and Kamin, D., 2019. *Taxing the Rich: Issues and Options* [online]. Available from: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3452274 [Accessed 2 November 2020].

[93] Wyden, R., 2019. *Treat Wealth Like Wages*. Washington, D.C.: Senate Finance Committee. Available from:

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the tax burden on the ultra-wealthy as well as increase the tax subsidy for charitable contributions. If one was concerned in the current tax environment that the relative contributions by ultra-wealthy donors and the government was skewed too much towards the use of public funds, then changes to increase the income tax burden on the wealthy exacerbate the problem of wealthy donors deciding how government funds are spent.

III. Should Tax Subsidies be Available to Support Charitable Activities Outside the U.S.?

The U.S. adopted much of the current tax regime covering the tax treatment of charitable entities and the deductibility of charitable contributions at a time when U.S. donors had relatively little interest in foreign charitable activities or entities. Whether Congress would have adopted a similar regime if contributions for foreign charitable activities or to foreign charitable entities played a much greater role in total charitable giving is unknowable. One way to address this question is to start with a baseline of tax subsidies for contributions to domestic charities or domestic charitable activities and then determine whether to extend these subsidies to contributions for foreign charitable activities and to contributions to foreign charitable entities.

A. Home Field Advantage: Should We Privilege Domestic Charitable Activity over Foreign Charitable Activity?

Consider this thought experiment.[94] Assume the U.S. and another country (or two countries in the European Union) are identical in every respect, including a currently under-provided public good or quasi-public good (for example, disease prevention programs or university education). Assume also the benefits of the externalities from the public good are enjoyed entirely locally. Should the U.S. tax its individual and corporate taxpayers to provide the same level of public goods in both countries?

As a matter of domestic tax policy, the answer is probably no. Despite calls by moral philosophers advocating greater cosmopolitan responsibilities, tax and spending policies in the U.S. are driven by the gains to its citizens and residents rather than to foreign beneficiaries. There is a strong intuitive appeal to helping those closer to us (both geographically and culturally) than those outside our borders. We give greater weight to the utilities of our citizens and residents and discount the utilities of foreigners. If we focus only on the overall welfare of our society (defined by national borders), then the externalities generated by domestic charitable activities will remain in our country while the externalities from foreign charitable activities accrue to others. Finally, if we view part of the bargain of providing tax benefits for charitable contributions as relieving government of the obligation of providing the goods and services directly, then favoring domestic

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https://www.finance.senate.gov/imo/media/doc/Treat%20Wealth%20Like%20Wages%20RM%20Wyden.pdf [Accessed 2 November 2020].

[94] Kane, *supra* note __.

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activities over foreign activities may reduce the demand for domestic government spending.

All of these arguments are subject to strong counterclaims. It is hard to make comparisons between deserving individual recipients in the U.S. and abroad. Questions as to who are more deserving beneficiaries raise difficult value judgments that are hard to evaluate without some normative framework or political compromise. It is also not clear whether we should take such a narrow view of society in measuring general welfare, especially given the international consequences of many local challenges. Finally, providing tax subsidies for foreign charitable activities may well result in reducing the burden on the U.S. government as it may allow for less direct U.S. government assistance to foreign countries.[95]

The important observation from the experiment is that if we cannot justify using general tax revenue to fund the foreign charitable activities, we should not use the charitable deduction as a means of providing public goods outside the United States. This provides a strong case for preferring tax benefits for domestic rather than foreign charitable activities.

Relaxing some of the assumptions of this experiment strengthens the case for U.S. tax subsidies for foreign charitable activities. First, let's assume that the U.S. government spending on charitable activities supported by tax subsidies in the other country generates positive externalities for the U.S. For example, the foreign spending could result in political and strategic advantages to the U.S. This help explains why we provide official development assistance to certain countries and not to others. Similarly, U.S. government spending and charitable activities on health and environmental programs in foreign countries could generate benefits that are global rather than local in nature. For these types of expenditures, a strong case could be made for taxing its individuals and corporations to fund these activities (or providing charitable tax subsidies).

Second, let's relax the assumption as to the two countries being identical. Now substantial differences may exist across countries as to relative income levels, poverty levels, disease prevention, or suffering from natural or man-made disasters. Countries could also differ in the relative success in providing basic services and the relative size and make-up of the charitable sector in both countries. This again presents a much stronger case for U.S. government spending—either directly or through charitable tax subsidies.[96]

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[95] Giving preference to domestic, rather than foreign, altruism for revenue reasons is also not clear-cut. If the revenue cost from charitable contributions is considered too large, it is not obvious without some normative framework that the place to start chopping is support for foreign charitable activities. The U.S. generally provides the same tax benefits to all types of charitable activities, even though one could imagine a regime where certain activities that generate higher levels of societal benefits (through greater externalities) receive greater tax benefits than activities where most of the benefits are captured by those making the contributions.

[96] Even if we decide as a matter of tax policy not to extend the charitable deduction to foreign charitable activities, this does not mean that there is no role for government's use of tax benefits to support foreign charitable activities. Assume, for example, the U.S. government decides to provide $1 billion in funding in 2020 for humanitarian aid to victims of the Beirut explosion. We could choose to provide the $1 billion

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How could we determine the optimal split for tax subsidies between domestic and foreign charitable activities? Here is another thought experiment. Assume a philosopher queen could decide how to allocate government charitable tax subsidies, say $50 billion a year. She could determine which charitable projects merit funding by adopting the approach used by for-profit managers and non-profit grant makers in determining how to allocate resources among competing projects. With information about the costs of the investment, the amount, and timing of potential returns, and an appropriate discount rate, grant makers would fund those projects with the greatest returns. So theoretically, if the philosopher queen had $50 billion a year to spend on charitable projects, she could rank projects from the highest return to the lowest return and fund projects until the funds are exhausted.

If there were only domestic charitable activities, she would only need to rank domestic charitable projects. In a world with both domestic and foreign charitable activity and a policy of not granting preferences to domestic charitable activities over foreign charitable activities, then the process is again a straightforward ranking with those projects with the highest returns funded without regard to geographical location.

But now assume some or great preference for domestic activity over foreign activity. She would then need to adjust the returns on foreign charitable activity by some factor, ranging from 0 to 1. In an America First world, the factor would be 0. In a world where the location of the charitable activity did not matter, the factor would be 1. Under this approach, a mix of domestic and foreign charitable projects would receive funding, with the relative mix determined by the relative discount applied to foreign projects.

B. Overview of Foreign Charitable Activities

Challenges exist in determining the size and scope of foreign charitable activities supported by U.S. donors and U.S. charities. Tables 3 and 4 below seek to provide some sense of the types of foreign charitable activities receiving substantial support.

The National Center for Charitable Statistics has compiled data from the tax returns of U.S. charities to determine which organizations have substantial international activities.

Table 3. List of U.S. Nonprofits that Give the Most to Foreign Charitable Activities

	Non-profit	NTEE Classification	Grant Expenditures
1	Gavi Alliance	International Relief	$1,470,812,729
2	Food for The Poor, Inc.	International Relief	$866,573,810
3	Direct Relief	International Relief	$794,960,941

directly through direct foreign assistance funded out of general tax revenue, or allow charitable deductions at a revenue cost of $1 billion to subsidize private assistance efforts in Lebanon. The question then becomes which alternative (or combination of the two) yields the greatest benefit—both in terms of choice of projects and the quality of the outputs.

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4	World Vision	International Relief	$706,466,654
5	Compassion International Incorporated	International Relief	$588,458,666
6	MAP International	International Relief	$576,398,289
7	Catholic Medical Mission Board, Inc.	International Relief	$554,862,050
8	Save The Children Federation, Inc.	International Relief	$498,746,784
9	Population Services International	Scientific Organization	$387,371,578
10	United States Fund for UNICEF	United Nations Association	$365,514,922

Source: National Center for Charitable Statistics (NCCS).

Note: The amounts of grant expenditures presented are derived from responses to question 3(A) in Part IX of the IRS Form 990 filed by each organization for fiscal year 2017 that asks for the total expenses related to "grants and other assistance to foreign organizations, foreign governments, and foreign individuals." The National Taxonomy of Exempt Entities (NTEE) is a classification system for tax-exempt organizations created by the IRS and the NCCS. All organizations on this list fall within the "International, Foreign Affairs, and National Security" NTEE major group area.

These organizations provide a variety of services (health care, poverty relief, disaster relief, scholarships, environmental, and humanitarian aid). While it is difficult to make direct comparisons between domestic and international charitable activities, a review of the largest foreign charitable organizations supports the position that international activities better fit traditional notions of charity than the current array of activities of domestic charitable entities.

A different story may emerge if we just focus on "friends of" organizations. Significant challenges exist in identifying which charities are "friends of" organizations if the words "friends of" are not included in the name of the organization. Table 4 sets forth a listing of some of the largest "friends of" organizations. Here, donors target contributions to foreign entities that donors may have a more direct affinity (such as educational institutions, cultural organizations, religious organizations, and foreign countries).

Table 4. "Friends of" Organization Based on Grants Made to Foreign Affiliates (2017)

	Non-profit	NTEE Classification	Grant Expenditures
1	Cambridge in America	International, Foreign Affairs, and National Security	$78,750,336
2	Friends of The Israel Defense Forces	International, Foreign Affairs, and National Security	$69,042,549
3	American Technion Society	Education	$55,334,498
4	American Friends of The Israel Museum	Arts, Culture, and Humanities	$51,199,921

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5	American Friends of The Hebrew University, Inc.	Education	$46,108,488
6	American Associates of Ben-Gurion University of the Negev, Inc.	Education	$37,738,195
7	Americans for Oxford, Inc.	Education	$36,343,411
8	American Friends of Tel Aviv University, Inc.	International, Foreign Affairs, and National Security	$30,194,134
9	American Friends of Magen David Adom	International, Foreign Affairs, and National Security	$19,668,102
10	American Friends of IDC	International, Foreign Affairs, and National Security	$19,055,7530

Source: National Center for Charitable Statistics (NCCS).

Note: This list contains only organizations that are classified by the IRS as organized for the purpose of providing monetary support for either a single entity (11) or multiple entities (12) under the National Taxonomy of Exempt Organized (NTEE). The amounts of grant expenditures presented are derived from responses to question 3(A) in Part IX of the IRS Form 990 filed by each organization for fiscal year 2017 that asks for the total expenses related to "grants and other assistance to foreign organizations, foreign governments, and foreign individuals."

For some readers, providing U.S. tax subsidies for contributions to these foreign entities has less appeal. U.S. taxpayer dollars may yield greater returns (at least in the U.S.) for support of U.S. educational institutions than subsidies for Cambridge, Oxford, and Israeli universities.[97] Similarly, one can make strong arguments for using U.S. government resources for funding for U.S. military veterans rather than members and former members of the Israeli Defense Forces.

Whether these concerns merit differential treatment for contributions related to foreign charitable activities is unclear. For many observers, an advantage of the current charitable tax regime is that it provides donors the ability to direct their funds (and matching Federal funds) to those charitable activities they wish to support. Just as it is difficult to compare the relative worthiness of different types of domestic charitable activities, it is hard to compare the relative value of domestic and foreign charitable activities.

Is there an optimal division of tax subsidies between domestic and foreign charitable activities? Assume a country decides to provide $50 billion per year in tax subsidies, how should it divide those subsidies between domestic and foreign charitable activities? Several alternatives exist: we could allocate all the subsidies to domestic charitable activities, allocate between domestic and foreign charitable activities based on some criteria, or allocate by letting donors decide where the subsidies should go. The first and third options are easy to implement. The second option raises a host of challenging issues such as whether U.S. policymakers should give greater weight to domestic over foreign charitable

[97] Similar arguments apply in the domestic context. The U.S. provides about $10 billion of charitable tax expenditures for contributions to U.S. educational institutions, with a large share going to Harvard, Yale, Stanford, and UCLA rather than more financially challenged universities, colleges, and junior colleges.

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activities and how to assess the relative "worthiness" of different types of domestic and foreign charitable activities.

Focusing only on foreign charitable activity, Congress could reach a different result in two main ways. First, it could adopt narrower standards for foreign charitable activity than the broad scope allowed for domestic charitable activity. For example, Congress could enact a "worthiness" approach limiting tax subsidies to certain types of activities (poverty reduction and disease prevention) but not to other activities (perhaps religious and cultural). If Congress decides to provide blanket preferences for domestic over foreign charitable activity, it could reduce the tax subsidies for foreign activity (or increase the tax subsidies for domestic activity).

IV. Should Contribution to Foreign Charities be Treated Differently from Contributions to U.S. Charities?

This section examines whether the U.S. should treat contributions to foreign charities differently than contributions to domestic charities. It first reviews the legislative history for restricting charitable deductions under the income tax to U.S. charities. It then reviews the different alternatives for structuring contributions to foreign charitable activities or foreign charities to qualify for charitable income tax deduction. Finally, it examines the benefits and costs for allowing direct contributions to foreign charities.

A. Geographical Limitations

With limited exceptions, U.S. tax law adopts a "water's-edge" policy by allowing donors to deduct for income tax purposes only contributions made to donees created or organized in the United States, or in any possession thereof, or under the laws of the United States, any State, the District of Columbia, or any possession of the United States.[98] The income tax regime initially allowed tax deductions for contributions made to foreign charities.[99] Congress adopted this "place of organization" restriction in 1938.[100] Here is the often-cited passage in the legislative history of the Revenue Act of 1938:

> The exemption from taxation of money or property devoted to charitable or other purposes is based upon the theory that the Government is compensated for the loss of revenue by its relief from financial burdens which would otherwise have to be met by appropriations from public funds and by benefits resulting from the promotion of general welfare. The United States derives no such benefit from gifts to foreign institutions, and the proposed limitation is consistent with the above theory.[101]

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[98] The limitation applies even if the foreign charity qualifies for tax-exemption under I.R.C. §501(c)(3).
[99] Dale, H.P., 1995. Foreign Charities. *Tax Lawyer*, 48(3), 655-704 at 660.
[100] *Id.*
[101] HR Rep. No. 75-1860, at 19-20 (1938).

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Professor Harvey Dale has persuasively described this passage as "bad history, bad philosophy, and bad logic."[102] It is bad history, because there was no Congressional quid pro quo requirement that charitable activities relieve government of an expense before allowing deductibility. Many types of domestic activities that qualify for tax benefits even though the government is not relieved of obligations to provide similar goods or services would not satisfy this requirement. Conversely, because of the current level of private assistance for foreign charitable activities, the U.S. government may be relieved of the burden of providing different types of foreign aid. It is also bad philosophy, as even in the 1930s this was a narrow view of the world in general and global philanthropy in particular.[103] Finally, it is bad logic. It makes little sense to deny a charitable deduction based on where the entity is organized but to allow charitable deductions to domestic entities that use some or all of their funds outside the United States.[104]

The strongest rationale for requiring a domestic entity as a pass-through for funds sent overseas is to increase accountability and transparency. This allows the IRS and state governments to have some oversight over the activities, even though the funds are spent outside the United States. If deductibility under Section 170 requires the IRS to determine that the contributions are used exclusively for charitable purposes and that no part of the earnings inure to the benefit of any private individual, it is important to have a U.S. intermediary, especially where the IRS lacks the ability and authority to audit activities outside the United States.[105]

Oversight concerns take on added importance in the post-September 11, 2001 world. The use of charitable organizations to support terrorist activities makes the costs of abuses related to foreign charitable activities greater than wasted U.S. tax dollars. While requiring foreign charities to use a U.S.-based intermediary may not be entirely effective in limiting the flow of funds to terrorist organizations, it potentially provides some help in limiting such abuses.[106]

B. Options for Funding Foreign Charitable Activities and Foreign Charities through a U.S.-Charitable Organization

The place of organization restriction merely increases the transaction costs of providing funds for foreign charitable activities and foreign charities. U.S. donors have multiple

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[102] Dale, *supra* note __, at 660-662; Pozen, *supra* note__ at 542-546.
[103] *Id.*
[104] Rev. Rul. 71-460, 1971-2 C.B. 231 provides that "a [domestic corporation's] activities are charitable within the meaning of section 501(c)(3) of the Code when carried on within the United States, the conduct of such activities elsewhere does not preclude the organization form qualifying as an exempt organization under that section."
[105] Wiedenbeck, P.J., 1985. Charitable Contributions: A Policy Perspective. *Missouri Law Review*, 50(1), 85-139.
[106] *See* note __, *supra*.

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options to funnel their contributions towards foreign charitable activities and foreign charities[107]:

1. The easiest method is for donors to contribute to U.S. public charities engaged in foreign charitable activities either directly or through making grants to foreign charities;

2. U.S. individuals or corporations can use private foundations to make grants to foreign charities. As discussed earlier, to avoid excise taxes and other penalties, private foundations must either exercise expenditure responsibility or determine that the foreign charity is the equivalent of a Section 501(c)(3) organization;

3. Donor-advised funds present similar opportunities for foreign charitable activities as private foundations. Donors can effectively direct funds to foreign activities and even to foreign charities as long as they exercise expenditure responsibility. Sponsors of donor-advised funds impose different restrictions, but as a practical matter donors can select a sponsor that will allow them to achieve their objectives;

4. "Friends of" organizations also provide an easy path to fund foreign charitable activities and foreign charities. As long as the organization does not act as a mere conduit, U.S. donors can use these organizations to engage in cross-border philanthropy;

5. Internet and other platforms allow for U.S. donors to choose foreign beneficiaries by effectively using the public charity status of a charitable intermediary. These platforms reduce transaction costs for individuals seeking to fund foreign projects. For example, CAF America, Give2Asia, and GlobalGiving provide individuals with funding opportunities for education, health, and other types of projects in different countries and may offer foreign charities an opportunity to achieve de facto friends of status.[108]

Because of the availability of these alternatives for funding foreign charitable activity and foreign charities, the tax barriers for cross-country philanthropy are remarkably low. The general rule remains that direct contributions to foreign charities are not deductible for income tax purposes. But the availability of U.S. intermediaries to channel contributions

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[107] In addition to these five alternative, other options exist, including having U.S. charities engaging in foreign charitable activity by setting up a foreign charity. Borrowing from the U.S. international tax-planning toolkit, the U.S. entity can elect to treat the foreign entity as a disregarded entity under the "check-the box" regulations. For U.S. tax purposes, the foreign entity is disregarded even though under foreign law the foreign entity is treated as a separate entity. For a discussion of the use of a "disregarded" foreign subsidiary charity in cross-border philanthropy, *see* Lewin, C. and Moran, C., 2019. *Charity Abroad: U.S. Donors' Options for International Philanthropy* [online]. Venable, LLP. Available from: https://www.venable.com/insights/publications/2019/07/charity-abroad-us-donors-options-for-international [Accessed 21 September 2020].

[108] *See, for example,* GlobalGiving [online]. Available from: http://www.globalgiving.org/ [Accessed 6 October 2020].

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to foreign charities and the ability of private foundations and donor-advised funds to obtain equivalency determinations of U.S. public charity status for foreign charities relatively quickly and inexpensively (through organizations such as NGOsource) means the U.S. regime is more a toll charge for contributions to foreign charity rather than a roadblock.[109]

C. Benefits and Costs of Allowing Deductibility for Direct Contributions to Foreign Charities

Assume for purposes of this discussion that there were no problems in monitoring the activities of domestic or foreign charities (or that the proportion of charities behaving badly were the same), and that we do not value domestic charitable activity over foreign charitable activity. Under these assumptions, we would want those organizations that were the most efficient providers of charitable services to receive tax subsidies. Many reasons exist why foreign charities would be more effective than U.S. charities in providing assistance in foreign countries. These could include better knowledge of local conditions, lack of language challenges, greater receptivity of beneficiaries to receive assistance from local providers, and lower operating costs. We should want the donations and the matching federal funds to go to the charities that provide the highest quality assistance. Allowing direct contributions to foreign charities will have the additional benefits of encouraging the growth and development of charitable sectors outside the U.S.

Another reason to provide deductibility for contributions to foreign charities is that some foreign countries may have regulatory regimes that are more effective in approving and monitoring charities than the IRS and State attorney generals. For example, the United Kingdom's Charity Commission likely provides more effective oversight of U.K. charitable organizations than U.S. oversight mechanisms.[110]

Allowing direct contributions to foreign charities avoids the complexity and transaction costs of the current regime. Given that it is relatively easy to get around the "place of organization" restriction, why make donors go through this extra step? U.S. charitable intermediaries would no longer collect a percentage of foreign contributions.

There are several potential costs of allowing direct contributions to foreign charities. The most important cost is giving up some or all of U.S. oversight over foreign charitable activity. While there may be incomplete vetting of applications for tax-exempt status and not robust monitoring of charitable activity by the IRS and State officials, there is at least some level of oversight by IRs and state officials. The tax returns (Form 990) provide helpful information in understanding the charities' operations and place oversight responsibility on officers and directors. Having an intermediate U.S. entity will also help in enforcing laws related to anti-terrorist financing and money-laundering. While other

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[109] For foreign charities that cannot qualify for equivalency to a U.S. public charity, contributions may qualify for deductibility for income tax purposes if the private foundation or donor-advised fund exercises expenditure responsibility.

[110] Davis, K.E. and Gelpern, A., 2010. Peer-to-Peer Financing for Development: Regulating the Intermediaries. *NYU Journal of International Law and Politics*, 42(4), 1209-1268 at 1261-63.

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countries and organization may have similar measures to address these concerns, it may be in U.S. interests to directly involved in monitoring the activities of foreign charities receiving contributions from U.S. donors.

Several alternatives have been offered to extend tax benefits to foreign charities while minimizing opportunities for abuse.[111] First, foreign charities could apply for the right to receive tax-deductible contributions in the same way they can currently apply for tax-exempt status.[112] Second, the IRS could establish an "approved foreign charity list" of those foreign charities that satisfied certain criteria based on a review by the IRS or the State Department, or some other agency. This approach shares much in common with the current Canadian and Irish systems where individual taxpayers can deduct contributions to foreign charities as long as the Canadian or Irish government has also contributed to those charities.[113] Third, the existing tax-treaty network could be used to provide for deductibility of contributions to foreign charities on a country-by-country basis. Currently, the U.S. provides treaty relief for U.S. residents with Canada, Israel, and Mexico.[114] These provisions generally allow U.S. residents to reduce their foreign source income by donations to foreign charities.[115] Finally, we could adopt a "substantial equivalent" approach, where charities in those countries whose charitable regulation meet some minimum guidelines would be eligible to receive deductible contributions.

This last alternative presents both opportunities and challenges. This substantial equivalent approach would reduce barriers to cross-border giving and provide donor greater choices in making charitable contributions. However, this approach may result in competition among countries to attract charitable organizations, not unlike tax competition for foreign investment. Even where countries adopt similar charitable regulation regime, countries can vary greatly in their appetite for monitoring and enforcing charitable regulations.

V. Conclusions

The U.S. regulatory regime provides relatively low tax barriers for U.S. donors to engage in cross-border philanthropy. From the beginning of the charitable deduction, U.S. tax law allowed tax benefits for contributions to domestic charities even if these charities spend some or all of the funds on charitable activities outside the U.S. (either directly or through grants to foreign entities). Since 1938, U.S. donors generally receive no income tax

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[111] Pozen, *supra* note __, at 594-96.

[112] Foreign charities currently can apply for tax-exempt status in the U.S. to qualify for certain Federal, state and local tax benefits.

[113] *See* Canada Revenue Agency, (2010). *Gifts to Certain Charitable Organizations Outside Canada*. Income Tax Information Circular No. IC84-3R6. Ottawa: Canada Revenue Agency. Available from: https://www.canada.ca/content/dam/cra-arc/formspubs/pub/ic84-3r6/ic84-3r6-e.pdf [Accessed 6 October 2020].

[114] *See* note __, *supra*.

[115] If this alternative is adopted, then the benefits could be expanded by relaxing limitations with respect to foreign source income.

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deductions for contributions made directly to foreign charities (these restrictions do not apply for gift and estate purposes).

But the bark is worse than the bite. Donors have many alternatives (with different levels of complexity and administrative costs) to direct funds to foreign charities and still receive U.S. income tax benefits. These include contributions to (i) domestic public charities or private foundations that effectively forward the funds to foreign charities, (ii) "friends of" organizations with affiliated foreign charities, (iii) donor advised funds with recommendations that the funds be transferred to designated foreign charities, and (iv) different platforms (such as CAF America, Give2Asia, and GlobalGiving) that facilitate transfers to foreign charities at a nominal charge). While the lack of deductibility for direct contributions may increase complexity and administrative costs, requiring a U.S. intermediary provides at least some degree of oversight and accountability for U.S. regulators.

Whether the U.S. charitable tax regime is desirable depends on how the inquiry is framed. One approach looks at the existing rationales for charitable tax subsidies and asks whether meaningful differences exist between domestic and foreign charitable activities and between foreign and domestic charitable entities that justify different tax treatment. Here, one can make a strong argument that the tax law should extend subsidies to foreign charitable activities and to foreign charitable entities (with some mechanism for confirming charitable status and monitoring). The relative strength of the argument depends on how foreign activities and foreign charities fit within the theoretical basis for charitable tax subsidies. Unfortunately, the U.S. lacks a coherent, comprehensive theory on why we should allow charitable tax subsidies for domestic charities engaged in domestic charitable activities. Just as current theories provide little guidance on how to compare the worthiness of different types of charitable domestic activities, they are of limited use in comparing the relative value between domestic charitable activities and entities and foreign charitable activities and entities. It is not surprising we struggle with the proper tax treatment for foreign activities and foreign charities. The current regime allows donors almost complete discretion in determining which countries should benefit from their share of the contributions (the after-tax amount of the contributions) as well as the government's share (the amount of the tax subsidy).

The question then becomes (for both domestic and foreign activities and charitable entities) whether the current charitable regime is the best way to achieve certain societal objectives. In the domestic context, the current regime has produced a robust charitable sector that increases the level of underprovided goods and services and allows donors to direct funds to activities that they believe merit support. Donors do many good things that local or Federal government would, or could not, provide. We can adopt a "take or leave it" approach that asks whether we are better off with the current tax regime than we would be without it. This recognizes a set of trade-offs that reflect decisions made as to which charitable activities deserve tax subsidies, the role of government in granting charitable status and monitoring activities, and the form of these subsidies under the income and estate and gift regimes.

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In the foreign context, it is not clear whether the same types of trade-offs would apply and whether the benefits of tax subsidies for foreign activities justify the costs. These differences may support providing tax subsidies for foreign charitable activities and entities, but not necessarily in the same form as the current domestic charitable regime.

In both the domestic and foreign context, a "bang for the buck" approach may support proposals for reforming the tax subsidies regimes to maximize returns for government revenues foregone. This requires examining the value of all tax benefits for charitable activity, not just the charitable deduction under the personal income tax. Part of this analysis would focus on who can take advantage of the tax subsidies and the relative contributions of donors and government in funding the charitable activities. For both domestic and foreign charitable activities and entities there may be a "tipping point" whereby the size of the tax subsidies relative to the donors' after-tax contribution no longer justifies allowing donors to determine where and how the matching portion of the government's contributions are spent.

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