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978-0-521-11641-1 - A Practical Guide to International Philanthropy

Jonathon R. Moore

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A Practical Guide to International Philanthropy

This book is a practical guide to the issues faced by philanthropists seeking to engage in international charitable activities and offers alternative approaches to traditional U.S.-based foundations. A significant portion of the regulatory burdens facing U.S. private foundations derives from tax benefits available to donors under U.S. law. A charitable organization must initially qualify and then be maintained under a complex regulatory regime. If some or all of these tax benefits are either unavailable or not needed, or if the tax advantages are outweighed by the burdens of regulatory compliance, foundations can be established in foreign jurisdictions. Charitable activities can then be operated flexibly and privately outside the constraints of the U.S. regulatory regime. For existing private foundations, this book suggests strategies designed to hedge against ever-increasing and intrusive regulation.

Jonathon R. Moore, an internationally recognized expert on the legal aspects of philanthropy, is a partner with the law firm of Moore & Bruce, LLP, in Washington, D.C., and London, England. His practice focuses on planning and compliance matters for exempt organizations and for non-U.S. and U.S. corporate and individual clients interested in establishing charitable organizations. He is a member of the District of Columbia and New York bars, the Committee on Exempt Organizations of the American Bar Association's Section on Taxation, the Philanthropic Advisors Network of the Council on Foundations, and the District of Columbia Estate Planning Council.

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Disclaimer

This book is not a comprehensive treatment of all the legal, tax, and accounting issues surrounding international philanthropy. It is intended rather as a practical guide and as a review of the major topics associated with international philanthropic endeavors. It is hoped that it will prove especially helpful to individuals and families wishing to establish a structure dedicated to international philanthropy, individuals currently working with U.S. or other national charitable foundations, and persons who advise or otherwise deal with these people and groups.

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This book is based on materials available as of August 1, 2009. The information contained herein is subject to change.

Readers' comments and corrections would be greatly appreciated. Please send these to jmoore@mooreandbruce.com. Updates to topics covered in this work are posted at <http://www.mooreandbruce.com>.

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Preface

There have been many developments in the law and regulation of international charities since the author's previous work on the subject, *International Charitable Foundations: An Introduction*, which was published in 2002 by Richmond Law & Tax Ltd. and Transnational Publishers Inc. Although that work is now out of print and seriously out of date, this book borrows liberally from it, not only in terms of organization and approach but also with respect to topics and areas of the law that are fundamentally unchanged.

Since the publication of the prior work, three watershed events have occurred that compel the pages that follow.

First, the September 11, 2001, terrorist attacks are unquestionably one of those historical markers against which ideas, practices, and laws are measured by before-and-after comparisons. The revelation that international terrorists utilized charitable structures as covert financing vehicles as well as instrumentalities of political patronage precipitated scrutiny of all international charitable activities from the Internal Revenue Service as well as the U.S. Treasury Department's other agencies charged with the detection and prosecution of international financial crimes. The most tangible manifestation of this enhanced scrutiny has been the Treasury Department's issuance of a series of guidelines of recommended best practices for U.S. charities involved in international activities. These guidelines are discussed in detail and constitute an evolving area of law that will require future monitoring by all who work in this area.

Second, the well-publicized decision by the American entrepreneur Warren Buffet to donate more than \$30 billion to the Bill and Melinda Gates Foundation will resonate throughout the regulatory regimes governing private foundations for years to come. The gift created a philanthropic behemoth with more than \$60 billion in assets, and in one act of generosity, rendered the Gates Foundation nearly six times the size of the next largest private foundation, the Ford Foundation. By comparison, a single private charity will now command assets exceeding the annual gross domestic product of more than fifty countries, including oil-rich Kuwait, and will have assets comparable to or exceeding those of numerous Fortune 500 corporations, including Boeing, Disney, and Home Depot. So much wealth in the hands of so few individuals, whether dedicated to public purposes – here,

improving education and health care – or otherwise, will inevitably precipitate calls for greater transparency, which will then be followed by new standards of regulation from those members of Congress and other branches of government who unabashedly will take the view that the Gates Foundation is not spending its philanthropic dollars wisely or appropriately.

Third, the trend toward enhanced regulation of all U.S.-based charities, public and private, in the name of reform has continued unabated. Major new legislation regulating charities was enacted in August 2006, and additional legislative initiatives are sure to follow, at both the federal and the state levels. Occasional abuses by well-known public charities – for example, the grants of excessive tax benefits to wealthy insiders in the Nature Conservancy relating to environmental easements – have unleashed congressional calls for new levels of regulation. Broadly speaking, the direction of these proposals is to extend the Sarbanes-Oxley “reforms” in corporate governance to the charitable arena. Driven by inherent congressional distrust of private wealth and of charitable vehicles created by the wealthy, increased levels of regulation are to be expected in the future.

The long-term implications of each of these trends for practitioners of international philanthropy are addressed in this book.

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“Give, and it shall be given unto you; good measure, pressed down, and shaken together, and running over, shall men give unto your bosom. For with the same measure that ye mete withal shall it be measured to you again.”

Luke 6:38

“And besides this, giving all diligence, add to your faith virtue; and to virtue knowledge; And to knowledge temperance; and to temperance patience; and to patience godliness; And to godliness brotherly kindness; and to brotherly kindness charity.”

2 Peter 1:5–7

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Who should read this book

You are successful and affluent. Perhaps you have become wealthy as an entrepreneur who has formed and grown a successful business. Perhaps you have achieved success as an investor by multiplying the capital you have accumulated from the sale of a business. Perhaps you have recently received a sizable inheritance. Now what?

Presumably the material wealth you now possess will be sufficient to maintain the standard of living you have set for yourself and your family so that you no longer need to “make a living.” So now is the time to ask yourself, What is my passion? For many, it will be golf, sailing, or travel. But for many others, such pursuits by themselves would not be fulfilling. For these persons, a wider cause – whether promoting education, alleviating poverty, promoting peace and understanding among nations, enhancing protection of the environment, or advancing science – beckons. Having spent much of your adult life pursuing financial security, success now accords the freedom to pursue goals that will benefit some segment of humankind. Just as your endeavors in business or investing have been notable, your philanthropic goals will likely target something significant.

This book is written for those families and individuals who are ready to pursue charitable goals seriously, as well as those who are already doing so. Its principles also apply to businesses seeking to set aside some portion of their potential or accumulated profits to devote to such pursuits. They also apply to existing U.S. foundations considering expansion of their scope and perhaps adoption of a hedging strategy in the event trends toward overreaching government regulation continue.

The pages that follow will examine factors and decisions that are inherently private. As will be explained in detail, U.S. tax disincentives drive numerous charitable organizations to operate as public charities. Public charities, however, usually expend a sizable portion of the gifts they receive each year for their charitable purposes and then each year again seek to raise additional resources to replenish those grants. If you contemplate funding an organization with a single or series of large gifts and wish to avoid raising new funding from outside sources on a continuing basis, you will not be interested in establishing a new public charity. Fundamentally, you will want to control the direction in operations of the philanthropic endeavors to be pursued.

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In evaluating whether to establish a private foundation, it is assumed that the purposes of the foundation will be innovative and uniquely responsive to a set of perceived problems – and perhaps controversial. Of course, if your philanthropic interests are addressed by an existing public charity, you may wish to devote your resources to furthering that entity's goals. In that case, join the organization, support it, and perhaps become a member of its board. If you can find such an organization, so that your charitable goals can be realized by piggybacking on an existing organizational and legal infrastructure created and maintained by a public charity, you can stop reading now.

To the extent, however, that existing charities may not fulfill your sense of what can or should be accomplished in any particular field of charitable endeavor – and in particular, your potential for leadership – this book will provide guidance on alternatives to pursuing your vision. Your efforts have generated the resources; it is your prerogative to pursue and advance your values and philanthropic goals. The vehicle for doing so will allow you to instill in your children or other family members or friends the values you are articulating and pursuing and attract a group of individuals that share these values and will help you implement them. Moreover, it will allow you to pass your unique charitable values on to succeeding generations and serve as a uniting force for your family and/or close circle of friends.

So how do you set up a foundation? What type of legal structure do you use and where do you establish it? Most individuals in the United States, that is, U.S. citizens and residents for tax purposes (so-called green-card holders), pursuing philanthropic goals will either participate in existing entities or establish private foundations under the law of a particular state. Frequently, decisions on structure will be driven by tax considerations as to the deductibility from federal and state income taxes or estate taxes and exclusion from gift taxes. Indeed, most of the current structure of regulation of U.S. charitable organizations derives from the tax benefits granted to donors and the exemption from taxation to the organizations themselves.

This book discusses the legal framework and mechanics of establishing a charitable entity that qualifies for tax benefits available under U.S. law. Those benefits, however, come with strings attached in the form of a complex regulatory regime, under which the charitable organization must initially qualify and then be operated and maintained. Moreover, in the wake of the September 11, 2001, terrorist attacks and the Enron-era corporate scandals, Congress, the Internal Revenue Service, and state legislatures are all actively looking for new ways to regulate charities. Stricter, and therefore more intrusive, regulation in some form or another will surely be a permanent part of the regulatory framework under which U.S.-based charities must operate in the future.

Where the tax benefits available under U.S. law are of minimal value because of the donor's individual tax circumstances, are not necessarily needed, or can be deliberately forgone, this book argues that foreign jurisdictions should be considered as the situs for the charity. In foreign jurisdictions, the charity can be operated flexibly – and privately – outside of the constraints of the U.S. regulatory regime

governing private foundations. This book provides a road map for establishing a charity in a foreign jurisdiction and describes the advantages and disadvantages of utilizing foreign charitable structures for U.S. citizens and residents.

For some individuals, the U.S. tax advantages available are more than outweighed by the burdens and constraints of regulatory compliance. For others, their charitable purposes are impossible to achieve under current U.S. regulations. For example, anonymity of gifts is virtually impossible from a U.S. private foundation. Likewise, devoting all of the profits from an ongoing business enterprise toward charitable purposes is prohibited by the U.S. private foundation regulatory regime. Such individuals may deliberately choose to forgo short-term tax benefits in favor of longer-term freedom accorded from a foreign foundation structure.

The ideas in this work may also appeal to families and individuals who are already operating private foundations in the United States and are concerned with the growing intrusiveness of government regulation of their charitable endeavors. For this group, the possibility of cloning the charitable organization outside of the United States represents a hedging strategy, so that if expanding regulation should become too burdensome, the charitable structure will already be in place for continuing philanthropic activities outside of the United States without interruption. In the interim, the foreign charitable structure can be test-driven. Just as investors employ multiple strategies to buffer risks inherent in any specific investment sector, establishment of a foreign private foundation can provide an alternative approach to pursuing charitable goals unconstrained by the burdens of multiple layers of government regulation in the United States.

This book is written for American philanthropists – current and potential. Although its author is a lawyer and the legal topography to be navigated in order to have a basic understanding of the area is complex, the approach of this book is practical and hands-on. The usual law review or legal textbook formats and their emphasis on footnoted minutiae are avoided. Although lawyers not expert in the area of exempt organizations may find the topics covered useful as a general overview of applicable law, this book does not hold itself out to be a comprehensive legal treatise. It is written for laypeople making decisions to create charitable organizations and for their advisers. Nevertheless, primary authorities and references are cited.

False charity

Many of the ideas in this book are controversial. Its subtitle could well be “Living with Anachronistic Internal Revenue Code Provisions Governing International Charitable Activities.” The observations herein and the possible alternative charitable structures described are most decidedly not mainstream thinking, and indeed may be perceived as dangerous, overly aggressive, or subversive by legislative and executive branch individuals charged with implementing, overseeing, and perhaps expanding the existing regimes regulating private foundations, particularly in the post–September 11 world.

None of the suggestions offered, however, should be understood to provide a road map to those who would subvert charitable or philanthropic enterprises for illegitimate purposes. Much has been written after September 11, 2001, about certain so-called Islamic charities. Although having names suggesting that their purposes, for example, are to alleviate poverty and hunger among children, some of these entities in fact have served as conduits for supporting terrorism. The subversion or perversion of charitable organizations for evil purposes should not be permitted to constrain the vast array of legitimate philanthropic organizations that are working creatively to address numerous problems of the world, which are not or cannot be remedied by governments or private enterprise.

Stated differently, none of the comments or suggestions in this book should be viewed as a guide to gaming the system or an invitation to subterfuge.

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