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Planning for Contributions to Foreign Charities by Individuals and Foundations

Published on Monday, August 22nd, 2005.

Planning for contributions by individuals and private foundations to foreign charities requires careful attention. In this article from the July 2005 issue of Estate Planning Journal, Philadelphia attorney Richard L. Fox reviews the complex tax rules as well as nontax laws and best practices aimed at preventing the diversion of contributions to fund terrorism.

by [Richard L. Fox](#) [1]

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RIA Estate Planning

International charitable giving by Americans has increased dramatically in recent years and is evolving as a tax planning area of significant importance.¹ [4] Contributions by individuals and private foundations to or for the benefit of foreign charities are subject to complex tax rules, often presenting formidable obstacles in making such contributions.² [5] There are a number of alternatives available to effectuate international charitable giving, however, while ensuring tax deductibility and compliance with the tax laws. Due consideration must also be given to various sanctions and best practices adopted in the aftermath of 9/11/01, which are aimed at preventing the funding of terrorism. Finally, when a contribution is made to a foreign charity to fund activities to be performed in the U.S., it is important to ensure compliance with the available exemptions from U.S. tax withholding obligations that otherwise apply.

Contributions to foreign charities by individuals

An individual making a contribution to a charitable organization is entitled to an income tax deduction under Section 170(a) only if the organization is "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."³ [6] Thus, contributions by individuals to a charity created or organized under foreign law are not deductible for income tax purposes.⁴ [7]

The legislative history to the Revenue Act of 1938⁵ [8] indicates, though, that Congress did not intend to preclude deductibility for a contribution to a domestic charity that, in turn, uses such funds to further its charitable purposes in foreign countries. Moreover, the Regulations explicitly address this situation, specifically providing that a "charitable deduction by an individual to an organization described in Section 170(c) is deductible even though all, or some portion, of the funds of the organization may be used in foreign countries for charitable or educational purposes."⁶ [9] Similarly, Rev. Rul. 63-252 provides that the limitation under Section 170(c) "relates only to the place of creation of the charitable organization to which contributions may be made and does not restrict the

area in which deductible contributions may be used."

Deductibility turning on the laws under which a donee charity is created or organized has been interpreted quite literally. In *Walti*,⁷ [10] for example, the court held that a contribution was not deductible because it was made to a church that was organized as a corporation under the laws of Switzerland, even though the church was for all intents and purposes merely a branch of a U.S. church organized under the laws of Massachusetts.⁸ [11] In *Bilingual Montessori School of Paris*,⁹ [12] contributions to an educational organization incorporated under the laws of Delaware were held to be deductible, although all its activities took place in France and it had no assets or employees in the U.S.

An individual desiring to further a program conducted abroad by a domestic charity can earmark a contribution expressly for that program (but not for a specified foreign charitable organization), so long as that program is subject to the control of the domestic charity. This is the case because a donor can determine which of a qualified organization's charitable purposes will receive the exclusive benefit of a contribution to the organization.¹⁰ [13] If an individual desires to make contributions specifically for the benefit of a particular foreign charitable organization, however, certain alternatives are available, as discussed below, to accomplish this on a tax-deductible basis, even though the intended donee organization is not a domestic charity and a contribution directly to such organization is not otherwise deductible.

U.S. 'Friends' Organizations

There are a multitude of U.S. "friends" organizations that are formed to support a specific foreign charity, such as the American Friends of the Paris Opera, the American Friends of the London Business School, and the American Friends of the Tel Aviv University. Although these domestic charities are established expressly for the purpose of raising funds in the U.S. that will ultimately be distributed to the foreign charities they support, they are organized to meet the legal requirements for contributions to be deductible for U.S. tax purposes.

In Rev. Rul. 63-252, the IRS addressed alternative factual situations regarding the deductibility of contributions to U.S. "friends" organizations. In the first example, a foreign organization caused a U.S. organization to be formed to (1) conduct a U.S. fund-raising campaign, (2) pay the administrative expenses from the collected funds, and (3) remit any balance to the foreign organization. In the second example, U.S. persons, desirous of furthering a foreign organization's work, form a U.S. organization whose charter provides that it will receive contributions and send them, at convenient intervals, to the foreign organization.

The IRS, citing *Thompson*,¹¹ [14] stated that the inquiry as to the deductibility of a contribution does not stop once it is determined that an amount has been paid to a qualifying domestic organization. Rather, if the amount is earmarked for a foreign charity, it is appropriate to look beyond the fact that the immediate recipient is a qualifying organization to determine whether the payment constitutes a deductible contribution. Similarly, if an organization is required for other reasons (such as a specific provision in its charter) to turn over contributions to a foreign charity, or if the contributions are otherwise inevitably committed to go to a foreign charity, the IRS stated that the real donee is the ultimate foreign recipient. On this ground, the IRS concluded that the contributions to the domestic charity in examples one and two are not deductible.

Similarly, in example three of Rev. Rul. 63-252, where the domestic organization represents to prospective contributors that the contributions it receives will be turned over to a foreign organization, the IRS determined that the contributions are not deductible. In these examples, the foreign charity was considered the real donee, and the domestic charity was merely a conduit.

Example three of this Ruling was subsequently amplified by Rev. Rul. 66-79,¹² [15] in which the IRS concluded that contributions to a domestic charity which are solicited for a specific project of a foreign charitable organization will be deductible under Section 170, provided that the domestic charity reviews and approves the project as being in furtherance of its own exempt purposes and has control and discretion as to the use of the contributions. If a U.S. "friends" organization is listed in the Cumulative List of Organizations described in Section 170(c), Publication 78, a contribution to the organization will generally be deductible for income tax purposes. Deductibility under Section 170(c) will be jeopardized only if a contribution to a U.S. "friends" organization listed in Publication 78 is specifically earmarked by an individual donor for a foreign charity.¹³ [16]

International Donor-Advised Funds

Donor-advised funds within community foundations and those sponsored by a multitude of mutual fund and brokerage companies generally prohibit recommendations of grants to foreign charities made by donor advisors and, accordingly, any such recommendations will not be approved. A number of domestic public charities, however, operate international donor-advised fund programs (such as United Way International, Charities Aid Foundation America, the King Baudouin Foundation, and the International Community Foundation) that do make grants to foreign charities based on recommendations made by the advisor to a donor-advised fund.

Prior to approving such recommendations, these organizations (1) conduct their own due diligence to ensure that the foreign charity recommended by a donor advisor is a bona fide charity that is in compliance with applicable foreign law governing charitable organizations, and (2) generally impose reporting obligations with respect to grants made to a foreign charity. Contributions to these domestic public charities are not considered earmarked for a foreign charity because any grant recommended to a foreign charity is subject to the final review and approval of the domestic public charity operating the donor-advised fund program, just as is the case with donor-advised funds within community foundations and those sponsored by mutual fund and brokerage companies. Thus, contributions to these organizations are deductible, despite the fact that they ultimately may be directed to foreign charities by the donor advisor.

Individuals considering making substantial gifts to an international donor-advised fund should confirm that the administrators of the public charity operating the fund will, in fact, establish adequate screening processes related to donor recommendations. Absent such a screening process, grants to foreign charities pursuant to donor recommendations may be considered as being made by an individual directly to a foreign charity, in which case no deduction would be allowable.

Private Foundations

No prohibition exists on a domestic private foundation making grants to foreign charities, provided that the foundation complies with the applicable Chapter 42 excise tax requirements with respect to foreign grants. An individual wishing to make significant grants to foreign charities, therefore, may be better served by creating and funding a domestic private foundation which, in turn, can engage in grant-making to foreign charities selected by the individual. Specific rules govern grants by private foundations to foreign charities, which are discussed below under the heading "Contributions to foreign charities by private foundations."

Supporting Organizations

Under Rev. Rul. 74-229,¹⁴ [17] a domestic organization that is organized and operated in support of a foreign charity that otherwise meets the requirements under Section 509(a)(3) can qualify as a supporting organization. Although Rev. Rul. 74-229 did not address deductibility issues under Section 170, it may be possible for the supporting organization to meet the "operated, supervised, or controlled by or in connection with" requirement of Section 509(a)(3)(B), but still retain control and

discretion over the contributions that it receives.

In this situation, although the funds will eventually be distributed to the foreign charity, they presumably should not be considered earmarked as such because the domestic supporting organization maintains control and discretion over the funds it receives. Given the highly technical nature of Section 509(a)(3) supporting organizations¹⁵ [18] and the adverse consequences incident to the denial of deductibility, practitioners should obtain a private letter ruling confirming that contributions by an individual to the domestic Section 509(a)(3) supporting organization formed to support a foreign organization are deductible under Section 170.¹⁶ [19]

Contributions to Foreign Charities by Private Foundations

Unless a foreign charity has been determined by the IRS to be a public charity for U.S. tax purposes (which is unusual because very few foreign charities seek such classification), a domestic private foundation must comply with very specific requirements in order to make a grant to a foreign charity without running afoul of the Chapter 42 requirements applicable to private foundations.

There are basically two methods to accomplish this. First, a domestic private foundation can make an "equivalency determination" that the foreign grantee is the equivalent of a U.S. charity; traditionally, this has been considered the only method available to accomplish a grant to a foreign charity. The second method, announced pursuant to an IRS general information letter dated 4/18/01, allows a domestic private foundation to exercise "expenditure responsibility," which includes the requirement that the foreign grantee maintain the grant funds in a separate fund dedicated to charitable purposes.¹⁷ [20]

Equivalency determination of status of foreign charity. An equivalency determination requires that the domestic private foundation make a good faith determination regarding the status of a foreign grantee under U.S. tax law based on either an affidavit of the foreign charity or an opinion of counsel.¹⁸ [21] Rev. Proc. 92-94¹⁹ [22] sets out the requirements for relying on an affidavit and describes the multitude of quantitative and qualitative information that the foreign charity must provide. Among the items of information required by the affidavit are a copy of the foreign charity's governing documents (which must be translated into English), several years of financial data, a description of activities, and various statements regarding local law or custom. Rev. Proc. 92-94 was intended to provide a "simplified procedure" to meet the good faith equivalency determination. Nevertheless, compliance with the affidavit requirements is often quite burdensome, if not impossible, for many foreign organizations, except for larger foreign organizations receiving substantial funding from U.S. foundations that often receive requests for currently qualified affidavits and can generally comply with little difficulty.

The alternative to obtaining an affidavit from the foreign charity is to obtain an opinion of counsel. The information that an attorney must generally review in order to issue an opinion is largely that required for the foreign grantee affidavit required by Rev. Proc. 92-94, so that obtaining an opinion of counsel may be expensive and not justified for smaller grants.

Assuming that a good faith determination is made by the domestic charity (by way of an affidavit or opinion of counsel), establishing that the foreign grantee is the equivalent of a public charity under U.S. tax laws, the grant to the foreign charity is treated as a qualifying distribution and the exercise of expenditure responsibility is not required. On the other hand, if the foreign grantee is determined to be the equivalent of a U.S. private foundation because it is not described in Section 509(a), the domestic private foundation must exercise expenditure responsibility with respect to the grant as prescribed by Section 4945(h) and the Regulations thereunder, and a qualifying distribution is generally not available.²⁰ [23]

IRS information letter: Equivalency determination no longer required, provided expenditure responsibility is exercised and separate fund is maintained. On 4/18/01, following a two-year effort by the Council on Foundations ("Council") to streamline international grant-making by U.S. private foundations, the IRS issued a general information letter to the Council concluding that nothing in the Internal Revenue Code ("IRC") or the Regulations requires a private foundation to inquire or evaluate whether it can make a good faith determination that a foreign charitable grantee organization is the equivalent of an Section 501(c)(3) organization and a public charity under Section 509(a).²¹ [24] Under the IRS general information letter, a U.S. private foundation, therefore, is not required to make an equivalency determination with respect to a proposed foreign grantee by obtaining an affidavit or an opinion of counsel, thereby avoiding a process that is often complex, expensive, and time-consuming. Instead, as long as the domestic private foundation complies with the expenditure responsibility requirements and requires the maintenance of a separate fund in which the grant funds are held, the foundation may make a grant to a foreign charity.

While general information letters are advisory in nature and have no binding effect on the IRS, they are intended to provide clarification of well-established interpretations of law. The Council has stated that it believes that all U.S. private foundation grant-makers "may be confident that the information letter obtained by the Council faithfully describes the IRS's views on expenditure responsibility" with respect to foreign grants. This conclusion appears to be absolutely correct, given that this methodology would otherwise be available for a grant by a domestic private foundation to a noncharitable organization.²² [25] Moreover, the IRS has since issued private letter rulings confirming that adherence to the procedures set forth in the information letter will ensure that a grant by a U.S. private foundation to a foreign organization will be treated as a qualifying distribution and not as a taxable expenditure.²³ [26]

Specifically, under the IRS general information letter, a private foundation may treat a grant to a foreign grantee as a qualifying distribution and not as a taxable expenditure if the private foundation (1) elects "to treat a foreign grantee as not being described in IRC 501(c)(3)" and (2) exercises expenditure responsibility with respect to the grant as prescribed under Section 4945(h) and the accompanying Regulations. This includes the requirement that the grantee organization must agree to continuously maintain the grant funds in a separate fund dedicated to one or more purposes described in Section 170(c)(2)(B).²⁴ [27]

A private foundation's ability to use the equivalency-determination rules of the Regulations is not affected by the IRS information letter. A private foundation may, therefore, still use either the affidavit or opinion-of-counsel approach to determine that a foreign charity is the equivalent of a Section 501(c)(3) organization and a public charity, in which case no expenditure responsibility would be required and the grant funds would not need to be held by the foreign charity in a separate fund.

Anti-Terrorism Provisions and Best Practice Guidelines

Besides complying with applicable provisions of the IRC, individuals and private foundations should be aware of the potential for criminal prosecution, civil penalties, and the freezing of their assets for making charitable contributions to foreign or domestic charities that engage in or support terrorism. Although the Treasury Department has previously issued "best practice" voluntary guidelines for U.S. charities to follow in order to reduce exposure to these sanctions, the guidelines are generally considered to be unworkable, have been the subject of much criticism, and have been nearly unanimously rejected by U.S. charities.

In addition, while the IRS has recently announced its intention to clarify and expand existing guidance with respect to international grant-making by U.S. charities in order to reduce the diversion of assets for noncharitable purposes, it has not yet issued any definitive guidance in this area. The end result is that U.S. grant-makers have struggled with how best to ensure compliance with various laws

prohibiting the support of terrorism, while still engaging in international philanthropy. These issues are generally discussed below.²⁵ [28]

Executive Order 13224 and the Patriot Act. Just days after the terrorist attacks of 9/11/01, President Bush issued Executive Order 13224, "Blocking Property and Prohibiting Transactions with Persons Who Commit, Threaten to Commit, or Support Terrorism" (the "Executive Order"). One month later, the USA PATRIOT Act, "Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism"²⁶ [29] (the "Patriot Act"), was signed into law.

The Executive Order provides a means to disrupt the financial support network for terrorists and terrorist organizations by authorizing the U.S. government to designate and block the assets of foreign individuals and entities that commit, or pose a significant risk of committing, acts of terrorism.²⁷ [30] The Executive Order also authorizes the U.S. government to block the assets of individuals and entities that provide support, services, or assistance to, or otherwise associate with, terrorists and terrorist organizations designated under the Executive Order. In addition, the Executive Order specifically prohibits engaging in any transaction involving designated persons, "including but not limited to the making or receiving of contributions of funds, goods, or services."²⁸ [31]

Once an entity or individual is designated under the Executive Order, the Office of Foreign Assets Control ("OFAC") of the Treasury Department takes appropriate action to block the assets of the individual or entity in the U.S. The OFAC then adds the individual or entity to its list of "Specially Designated Nationals and Blocked Persons."²⁹ [32] The list is not limited to foreign organizations since U.S. individuals or entities (including U.S. charitable organizations) that provide support for terrorism may be designated persons. Indeed, shortly after 9/11/01, the assets of three U.S. public charities were blocked, as the charities were designated as supporters of terrorism.³⁰ [33] In February 2004, the assets of a fourth U.S. public charity were blocked, pending an investigation into the organization's possible ties to terrorism.³¹ [34] Of particular importance is that Executive Order 13224 does not require knowledge or intent, so that making a contribution to a designated entity may subject the donor to sanctions, even though the donor did not intend to support terrorism and did not know that the grant would be used for such purposes.

Prior to the Patriot Act, Title 18 of the United States Code already included criminal sanctions for persons who provided materials or financial support for terrorism and for "foreign terrorist organizations" ("FTOs") in particular. The Patriot Act supplemented those provisions by amending Title 18 to expand the scope of criminal prosecution for providing support to terrorist organizations and increasing penalties for noncompliance. Under these supplemented provisions, substantial civil penalties or prison terms up to 15 years, or both, are imposed for providing material support or resources, knowing or intending that they will be used for terrorism or by an FTO.³² [35] "Material support or resources" for this purpose is broadly defined and clearly would include grants used by a recipient to engage in terrorist acts or if the recipient is an FTO.³³ [36]

In June 2002, Title 18 was once again supplemented by criminalizing the "financing of terrorism," whereby substantial civil penalties or prison terms of up to 20 years, or both, are imposed if a person willfully provides or collects funds with the intention that such funds be used to carry out acts of terrorism or to support an FTO.³⁴ [37] The OFAC's list of "Specially Designated Nationals and Blocked Persons" includes organizations that have been designated as FTOs.

Treasury Department's anti-terrorism 'best practices.' In November 2002, the Treasury Department issued "Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities," which were developed in response to concerns of members in the Arab-American and American Muslim communities about the decline in charitable giving in their communities in the aftermath of the Treasury Department's "blocking action" against three U.S. public charities found to support

terrorist organizations.³⁵ [38] These guidelines are entirely voluntary but, according to the press release announcing the issuance of the guidelines, if a U.S.-based charity follows these guidelines, "there will be a corresponding reduction in the likelihood of a blocking order against any such charity or donors who contribute to such charity in good faith, absent knowledge or intent to provide financing or support to terrorist organizations."³⁶ [39]

In addition to containing certain standard suggestions for organizational transparency, the guidelines provide for U.S. organizations to perform significant due diligence and collect an abundance of information prior to distributing funds to foreign organizations, including the following:³⁷ [40]

1. The charity should collect certain "basic" information about a foreign recipient.³⁸ [41]
2. The charity should conduct basic vetting of potential foreign recipient organizations:
 - a. The charity should be able to demonstrate that it conducted a reasonable search of public information to determine whether the foreign recipient is or has been implicated in any questionable activity.
 - b. The charity should be able to demonstrate that it has verified that the foreign recipient organization does not appear on any list of the U.S. Government, the United Nations, or the European Union identifying it as having links to terrorism or money laundering.³⁹ [42]
 - c. The charity should obtain the full name in English, in the language of origin, and any acronym or other names used, as well as the nationality, citizenship, current country of residence, place and date of birth for key staff at the foreign recipient organization's principal place of business (such as board members) and for senior employees at other locations. The charity should then run the names through public databases and compare them to the lists noted above.
 - d. The charity should require the foreign recipient organizations to certify that they do not employ or deal with any entities or individuals on the list noted above, or with any entities or individuals known to the foreign recipient organization to support terrorism.
3. The charity should review the financial operations of the foreign recipient organization:
 - a. The charity should determine the identity of the financial institutions with which the foreign organization maintains accounts.
 - b. The charity should require periodic reports from the foreign recipient organization on its operational activities and use of the disbursed funds.
 - c. The charity should require the foreign recipient organization to undertake reasonable steps to ensure that funds provided by the charity are not ultimately distributed to terrorist organizations. Periodically, the foreign recipient should apprise the charity of the steps it has taken to meet this goal.
 - d. The charity should perform routine, on-sight audits of the foreign recipient organizations whenever possible, consistent with the size of the disbursement and the cost of the audit.

The voluntary guidelines have been soundly criticized for failing to take into account existing laws requiring oversight of foreign grants and the experience of U.S. grant-makers in making such grants. The guidelines were also faulted for adopting a one-size-fits-all approach, for being so broadly and vaguely worded that compliance would be costly and difficult-if not impossible-to achieve, and for having a counterproductive effect of discouraging support for bona fide international charitable purposes.⁴⁰ [43] As a result, almost across the board, charitable organizations have expressed

dissatisfaction with the guidelines.

After considering comments made by U.S. charities in response to the voluntary guidelines and requests that the guidelines be withdrawn and reissued in a revised form (including producing a regularly updated and consolidated list of clearly identifiable blocked organizations and individuals), the Treasury Department invited a group of charitable organizations to engage in discussions regarding the guidelines on 4/28/04. After the meeting, representatives of more than 25 charities worked to develop a more usable alternative to the guidelines. The new alternatives were released in final form in March 2005 in a document entitled "Principles of International Charity," ⁴¹ [44] with the hope that they will replace the Treasury Department's voluntary guidelines.

IRS Announcement 2003-29. Following the Treasury Department's release of its voluntary guidelines, the IRS, in Ann. 2003-29, ⁴² [45] requested public comments on how it might clarify or expand existing guidance under Section 501(c)(3) with respect to international grant-making and other international activities. According to the Announcement, the IRS is particularly interested in comments on how new guidance "might reduce the possibility of diversion of assets for non-charitable purposes while preserving the important role of charitable organizations world-wide."

Unlike the Treasury Department's voluntary guidelines, which focus on law enforcement issues relating to the funding of terrorism (such as compliance with the Patriot Act and Executive Order 13224), the focus of the IRS is on ensuring compliance with Section 501(c)(3). The IRS has received an abundance of comments in response to Ann. 2003-29 and is currently in the process of determining whether new guidance is, in fact, required in this area, and whether changes to Forms 990 and 990-PF are required to better reflect foreign grant-making. At this point, the IRS has not issued any further guidance in this area.

Basic Steps for U.S. Grant-Makers Engaging in International Philanthropy

Contributions to foreign charitable organizations generally have little risk of being diverted to support terrorism since, in most cases, they will be made to well-known and reputable foreign charities. It is important, though, for U.S. grant-makers engaged in international philanthropy to assess the risk of such a diversion and to adopt and follow policies and procedures so as not to inadvertently run afoul of the Patriot Act or Executive Order 13224. While this is an area that is clearly evolving and the policies and procedures generally will vary depending on the nature of the particular grant and donee organization, the following basic steps should be considered when making grants to foreign charities, particularly if the proposed foreign donee is not a well-established charity:

1. Ensure that the proposed foreign charitable donee is not on the OFAC list of "Specially Designated Nationals and Blocked Persons." ⁴³ [46] One useful source where an organization's name can be checked against this list is the Excluded Parties List System ("EPLS"), which can be found at www.epls.gov [47]. ⁴⁴ [48] If an organization makes numerous foreign grants, the use of software programs to run automated checks should be considered, including those checking multiple terrorist lists, such as those of the Justice Department, the United Nations, and the European Union. ⁴⁵ [49]
2. Conduct due diligence to ensure that the proposed foreign donee is a bona fide charitable organization. This should include obtaining organizational documents, financial statements and tax returns, information about the organization's charitable programs, history, board of trustees and key employees, and the identity and qualifications of the individuals administering the grant. ⁴⁶ [50] Knowing the foreign grantee organization is probably the best way to avoid the diversion of funds from their intended charitable purposes, more so than checking any list purportedly containing the name of terrorists or their supporters.
3. Based on (1) the information obtained about the foreign grantee, (2) the U.S. grant-maker's own

prior experience with the proposed grantee, and (3) other relevant information (such as the country where the proposed grantee is located and whether that country has its own anti-terrorism protections), assess the risk of diversion of the grant to support terrorism and take appropriate steps to minimize any perceived risk. Steps to minimize risk could include obtaining references from third-party reliable sources and information regarding the organization's internal controls and oversight procedures, disbursing funds on a periodic short-term basis and requiring reports on previously expended funds, restricting the use of the grant to specific charitable purposes, and using a reliable third party located in the same country as the proposed foreign donee to assist with the administration and monitoring of the grant.

Another alternative to consider is to obtain a pre-grant certification from a potential donee organization that it does not support or fund terrorism and that it takes appropriate steps to ensure that grant funds are not ultimately distributed to terrorist organizations. The mere presence of a risk of diversion of funds should not necessarily be a reason not to make a grant, provided that in response to such a risk the organization exercises reasonable care and adequate precautions to minimize the risk. Where the organization is not willing or able to minimize the risk of the diversion of the grant funds, however, the grant should not be made.

4. Fully document the due diligence and all steps taken with respect to the proposed foreign grantee, the assessment of the risk that the grant will be diverted for terrorism, and steps taken to minimize any perceived risk.

5. Rather than making grants directly to foreign charities, consider making the grant to a bona fide and well-established U.S.-based international donor-advised fund or U.S. "friends" organization that will conduct its own due diligence prior to making a grant to a foreign organization.⁴⁷ [51]

U.S. Withholding Tax Considerations

Withholding generally required if foreign grantee will conduct activities in the U. S. Unless an exemption applies, as discussed below, a grant by a U.S. person, including a U.S.-based private foundation, to a foreign charity is subject to a 30% U.S. withholding tax if the grant will result in activities being performed in the U.S.⁴⁸ [52] Consequently, if it can be established that the activities to be conducted as a result of the grant will be performed entirely outside the U.S., no withholding is required and no special forms or procedures are necessary. For example, if the written grant agreement with a foreign charity specifically states that the grant must be used entirely to conduct activities outside the U.S., no U.S. tax withholding obligation applies.

If only some activities will be conducted in the U.S. by a foreign charity, U.S. tax withholding applies only to that portion of the grant that can be established with certainty will be used for activities in the U.S. If such certainty cannot be established, a U.S. tax withholding obligation technically applies to the entire grant. As a result, unless a specific exemption applies, where only a portion of the grant will be used to perform activities in the U.S., it is best to establish a specific amount of the grant that will fund U.S.-based activities or to have two separate grant agreements—one to fund activities performed entirely outside the U.S. and the other for activities performed entirely in the U.S. In most cases, an exemption from U.S. tax withholding obligations will apply to a grant to a foreign charity conducting activities in the U.S., but it is important to ensure compliance with the formal requirements applicable to such exemption.

Available exemptions from withholding tax requirements. Even if a grant to a foreign charity will be used to fund U.S.-based activities, there is no U.S. tax withholding obligation where (1) the grant is not subject to U.S. tax under a U.S. tax treaty provision, or (2) the foreign charity is described in Section 501(c)(3). To avoid withholding requirements based on a U.S. treaty provision exempting the payment from U.S. taxation, the foreign charity must provide the U.S. grant-maker with a completed Form W-8BEN, which must contain the foreign charity's Taxpayer Identification Number ("TIN")

and the treaty provision under which the payment is exempt from tax.⁴⁹ [53] To avoid withholding obligations on the basis that the foreign charity is described in Section 501(c)(3), the foreign charity must provide the U.S. grant-maker with a completed Form W-8EXP that includes its TIN, which must be accompanied by either an IRS determination letter establishing the tax-exempt status of the foreign charity or an opinion of U.S. counsel that the foreign charity is described in Section 501(c)(3).⁵⁰ [54]

Conclusion

International charitable giving by U.S. individuals and private foundations requires precise attention to complex tax rules, although there are a number of alternatives available to simplify such giving. Moreover, in the aftermath of 9/11/01, certain precautions should be taken to avoid inadvertently becoming subject to laws prohibiting the support of terrorism. Finally, if a grant made to a foreign charity will be used to fund activities to be performed in the U.S., it is important to ensure compliance with the available exemptions from U.S. withholding tax obligations.

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1. International charitable giving by U.S. private and community foundations, which includes grants to overseas recipients and funding for U.S.-based international programs, reached \$3 billion for the fourth year in a row in 2003, according to "International Grantmaking III: An Update on U.S. Foundation Trends," a report prepared and published by Foundation Center, with the support and collaboration of the Council on Foundations.^{back} [55]
 2. See, e.g., Crimm, "Global Philanthropy Depends on Tax Laws," *The Chronicle of Philanthropy* (4/3/03).^{back} [56]
 3. Section 170(c)(2)(A). In planning for contributions to support foreign charities, U.S. treaties with other countries should also be considered. The U.S. has treaty provisions with Mexico, Israel, and Canada providing for reciprocal deductibility of contributions to charitable organizations, so that contributions by U.S. individuals to charities organized in these countries are eligible for an income tax deduction.^{back} [57]
 4. Deductibility for estate and gift tax purposes is more liberal than for income tax purposes, as a full estate and gift tax deduction is allowed for bequests and gifts to any corporation organized and operated for charitable purposes. See Sections 2055(a)(2) and 2522(a)(2).^{back} [58]
 5. See H. Rep't No. 1860, Revenue Act of 1938, 75th Cong., 3d Sess.^{back} [59]
 6. Reg. 1.170A-8(a)(1) (emphasis added).^{back} [60]
 7. 1 TC 905 (1943).^{back} [61]
 8. See, however, Rev. Rul. 63-252, 1963-2 CB 101, allowing a deduction where the foreign charitable organization "is merely an administrative arm of the domestic organization."^{back} [62]
 9. 75 TC 480 (1980).^{back} [63]
 10. See Winn, Jr., 595 F.2d 1060, 44 AFTR2d 79-5076 (CA-5, 1979).^{back} [64]
 11. 2 TC 441 (1943).^{back} [65]