



EFC LEGAL AND FISCAL COUNTRY PROFILE

*The operating environment for
foundations*

USA – 2015

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The operating environment for foundations

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I. Legal framework for foundations

1. Does the jurisdiction have a basic legal definition of a foundation (Description where applicable)? What different legal types of foundation exist (autonomous, non-autonomous without legal personality, civil law, public law, church law, corporate foundations, enterprise foundations)?

The US law of charities is not found in a single unified statute or code or even in a single area of law. Yet because of the magnitude of tax incentives available to non-profit organizations, it is federal tax law that has become a key focus. Indeed, as further discussed below, the tax law definition of charity has effectively replaced the common law definition of charity.

The traditional common law definition of charity, as derived from English common law, speaks of four charitable purposes: the relief of poverty, the advancement of education, the advancement of religion, and other purposes beneficial to the community.¹ This tradition has influenced the American law of charities.² In the modern era, however, the traditional definition has been largely superseded in the United States by the tax law definition of charity – that is, by the definition of an organization that pays no tax on its income and whose donors derive a tax benefit as a result of their charitable donations.

Federal tax law is found in the Internal Revenue Code of 1986, as amended from time to time. The Internal Revenue Code cannot be understood, however, without reference to the Income Tax Regulations, which are issued by the Department of Treasury. The Internal Revenue Service, commonly known as the IRS, administers the federal tax system.

Since 1969 U.S. federal tax law has divided charities into two categories: public charities and private foundations. A private foundation is typically supported by one family, company, or individual, or by the income the foundation receives from investing its endowment. The public charity category, on the other hand, includes religious institutions, schools and universities, hospitals, and charities that are supported by a broad base of donors or consumers.³ Private foundations are more heavily regulated than public charities, and certain tax rules differ depending on whether a charity is a private foundation or a public charity. The vast majority of charities in the U.S. are public charities. Unless otherwise noted below, when answering questions about “foundations” for purposes of this report, we will generally discuss the law applicable to public charities, and we will use the terms “charity” or “charitable organization” generically to describe these entities.

To qualify for tax-exempt charitable status, an organization must satisfy the requirements of Section 501(c)(3) of the Internal Revenue Code. That statute defines tax-exempt charitable organizations in language that puzzles most readers:

‘Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation (...), and which does not participate in, or

¹ *Commissioners for Special Purposes of Income Tax v. Pemsel*, AC 531 (1891).

² See generally A.W. Scott, W.E. Fracher, and Mark L. Asher, *SCOTT AND ASHER ON TRUSTS* (5th ed., 2006).

³ This distinction bears no relation to the civil law distinction between associations and foundations. Moreover, having the word ‘foundation’ in the charity’s name does not make it a private foundation.

intervene in (including the publishing or distribution of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.'

The plain English meaning of this definition is addressed in Question II.1 below.

While charities are the best known segment of the American non-profit sector, there are more than 30 other different types of tax-exempt organizations, ranging from trade unions to social clubs to cemeteries to political committees. Again, federal tax law, mainly in Section 501(c) of the Internal Revenue Code, provides definitions and categories. A discussion of categories outside of 501(c)(3) is beyond the scope of this report.

A charity or other non-profit entity's tax status is a matter of federal law, but its existence as a legal entity and its internal governance are matters of state law. Furthermore, in addition to federal tax law, almost all of the fifty states and the District of Columbia have different legal frameworks that apply to certain non-profit legal entities and/or that provide tax exemption for certain types of legal entities. The discussion in this report will not focus on any one particular state's law, but will reference state law as a general matter. Please note that each of the fifty states' laws as applicable to charitable organizations are different, and with respect to any particular U.S. charitable organization, the relevant state's particular law should be consulted before determining what restrictions apply to such organization. Where the questions below reference "the State," we have addressed both federal and state law, if and as applicable.

Unless otherwise noted, we are assuming that the entities discussed in this report are nonprofit corporations (as opposed to trusts, unincorporated associations, limited liability companies, or other forms), since most charities in the U.S. are organized as nonprofit corporations. We are also assuming that all are organized for a purpose recognized under Section 501(c)(3) of the Internal Revenue Code. As noted above, while the questions refer to "foundations," we are focusing this discussion on public charities and not private foundations, unless otherwise noted.

2. What purposes can foundations pursue?

As noted above, under federal tax law, charitable organizations must have an exempt purpose, such as:

- *Religious*
- *Charitable*
- *Scientific*
- *Testing for public safety*
- *Literary*
- *Educational or*
- *For the prevention of cruelty to children or animals*

Many of these broad categories have sub-categories under which an organization may qualify for tax exemption. The organization's charitable purpose must be set forth in its organizing document.

Under state law, a charitable organization must usually act consistently with the charitable purposes set forth in its organizing document, and its assets are impressed with a charitable trust and may not be used for a purpose broader than the one established in the organizing document.

3. What are the requirements for the setting up of a foundation (procedure, registration, approval)? What application documents are required? Are there any other specific criteria for registration?

Formation of a new charitable entity requires filing organizing document (e.g., the Articles of Incorporation or a Certificate of Incorporation, also known as the “charter”) with the state. For tax exemption, approval is required from federal and (if the state has an corporate income or franchise tax) state tax authorities. Federal tax exemption is obtained by filing a Form 1023 exemption application.

4. Is State approval required? (approval by a State Supervisory Authority with/without discretion? Registration with a state authority or court? Notarisation by a Notary public?)

At the state level, before an entity may be legally formed, organizing documents (e.g., the Articles or Certificate of Incorporation) must be accepted by the state’s Secretary of State or equivalent, as being in compliance with the statutory requirements of that state’s corporate laws regarding non-profit corporations.

For tax exemption of charities, approval is required from federal and (if applicable) state tax authorities. An authorized representative of the charity signs the federal exemption application under penalties of perjury; no notarization is required. Approval or denial of the exemption application is within the discretion of the Internal Revenue Service.

5. Do foundations have to register? If yes, in what register?

All charities must register with the Internal Revenue Service, first by obtaining a taxpayer identification number, and later by applying for tax exemption. Most states require organizations doing business within the state and/or that solicit charitable contributions within the state to register with the state.

a) If foundations are registered, what information is kept at the register?

Almost all charities must file an annual information return with the Internal Revenue Service on Form 990 (990-PF for private foundations, 990-N for very small charitable organizations) and most must file an annual information return with state tax authorities (if the state(s) in which the organization is located have a corporate income or franchise tax). Annual information statements contain a report of the organization’s assets and liabilities, revenue and expenses, and other financial and operational information, including donor and compensation data.

Most state registrars (typically the Secretary of State and/or Attorney General) receive an annual or biannual information filing, which is usually less detailed than the annual federal tax filing.

b) If foundations are registered, is the register publicly available?

Yes. The annual federal Internal Revenue Service tax filing is subject to public disclosure, though most charities’ donors are not disclosed to the public (private foundation donors *are* disclosed to the public). Many states also publish charities’ annual information statements. If the state requires the

charity to obtain and submit audited financial statements, those financial statements may also be subject to public disclosure.

6. Is a minimum founding capital required? Is the foundation required to maintain these assets or any other specified asset level throughout its lifetime?

There is no minimum founding capital required, and organizations are not required to maintain any specified asset level throughout their lifetime.

7. What governance requirements are set out in the law?

State law sets forth certain governance requirements for charitable organizations, including directors' fiduciary duties of care and loyalty. The federal tax law establishes no specific governance requirements, but the Internal Revenue Service does have an interest in fostering sound governance, and has the authority to penalize improper benefits to insiders.

a) Is it mandatory to have a supervisory board?

The entity may have no more than one ultimate governing body, typically referred to as a board of directors. The concept of a supervisory board does not exist in American corporate law.

b) What are the requirements concerning board members? Is a minimum/maximum number of board members specified? What are the rules concerning appointment of board members? And their resignation/removal?

State law typically dictates the minimum number of directors required, and typically there is no mandated maximum. State statute and the internal bylaws of the corporation will govern appointment or election of directors and their resignation/removal.

c) What are the duties and what are the rights of board members, as specified by national legislation?

Federal law is largely silent on the rights and duties of board members. Under state law, directors are fiduciaries of the corporation and have duties of care and loyalty to the corporation.

d) What are the rights of founders?

For charities established as corporations, founders typically have no special legal authority under federal or state law, though it is possible for founders to incorporate special rights or duties into the internal governance documents of the corporation. For example, a founder may, at the beginning of the corporation's existence, appoint herself the sole member of the corporation, with exclusive authority to appoint and remove directors. In addition, as donors, founders may impose purpose restrictions at the time of the donations, creating a "charitable trust" restriction that must be respected by the charity. See the question and response immediately below for more information.

In charities established in the trust form, the founder, called the trustor or settlor, can irrevocably provide for the initial trustees and successor trustees, or set forth a manner in which successor trustees are selected. The trustor could also irrevocably limit the use of assets for particular purposes.

e) Can fundamental decisions, such as change of purpose, be made at the discretion of the founder? What are the legal requirements in such circumstances?

Founders are typically also donors, and donors can impose purpose restrictions at the time of the donations, creating a “charitable trust” restriction that must be respected by the charity. Charities can ask a living donor to later change or terminate the purpose restriction under principles articulated in the Uniform Prudent Management of Institutional Funds Act. Other than their rights as funders, founders typically have no special legal authority under federal or state law, although as noted above, it is possible for founders to incorporate special rights or duties into the internal governance documents of the corporation. Founders have no inherent rights affirmatively to make fundamental decisions.

f) What are the rights of beneficiaries (e.g. right of information)?

Under U.S. law, the public is treated as the beneficiaries of a charity, and the states’ Attorneys General have oversight over charities on behalf of the public, including rights of audit and inspection. Grantees or other direct beneficiaries of a charity have no special rights of access to information. If the corporation has members, they usually have statutory rights of inspection and the right to receive certain financial reports.

g) What rules are in place to ensure against conflict of interest? What is the legal definition of a conflict of interest under your legislation? How is self-dealing prohibited?

There is no single definition of conflict of interest. Federal tax law imposes a prohibition on private inurement, which is the provision of improper benefits to a charity’s insiders. Section 4958 of the Internal Revenue Code gives the Internal Revenue Service the power, with regard to public charities, to impose penalties on the individuals, including potentially the charity’s directors, who benefit from, or who approve, certain private inurement transactions. At the same time, the law provides that if a disinterested board or board committee approves a transaction with an insider after appropriate investigation and review, the transaction will be entitled to a presumption of reasonableness. The result of this regime is that an insider, and any board that approves any transaction with an insider, especially without following the prescribed review procedures, risk personal liability if the Internal Revenue Service later determines that the insider received excessive benefits from the charity. The rules governing conflict of interest transactions between private foundations and their insiders are much more strict and prohibit most self-dealing transactions.

State law addresses conflicts through imposition of fiduciary duties of care and loyalty, and through the application of restrictions on transactions between the corporation and its directors. In most cases, transactions between a corporation and a director are permitted if they are fair and reasonable to the corporation.

h) Can staff (director and/or officers) participate in decision making? How and to what extent?

Staff may be invited to attend and participate in Board of Directors meetings. There is typically no prohibition on staff being members of the governing body (but state law may restrict the number of

compensated individuals who may also serve as directors).

8. Who can represent a foundation towards third parties? Is this specified in law or is it up to the statutes of the organisation?

Per state law, the Board can act on behalf of the corporation. The corporation's governing documents should articulate the officer positions and the scope of their authority; officers typically have some authority to act on behalf of the corporation, under the ultimate guidance of the Board of Directors.

a) Do the director and officers have powers of representation?

The board may delegate its authority and power to speak on behalf of the corporation; state law usually defines the scope of the board's ability to delegate, and other parties' ability to rely on delegates.

9. Liability of the foundation and its organs

a) What is the general standard of diligence for board members? Does your country differentiate between voluntary (unpaid) and paid board members?

Directors generally have a duty to act in good faith, in a manner that the director believes to be in the best interests of the corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances. State law may differentiate between paid and voluntary directors, and may provide additional protections to volunteer directors.

b) Is there a "business judgment rule", giving a board member a "safe harbour", if she/he (1) acts on an informed basis; (2) acts in good faith, (3) acts in the best interests of the corporation, (4) does not act out of self-interest (duty of loyalty concept plays a role here), and (5) is not wasteful?

Yes, the business judgment rule is usually defined through state case law and/or state statute. The specific contours of the rule may differ from state to state, but generally, under this rule, courts will not second-guess the decisions of directors who acted in good faith, without personal interest, and with due care – i.e., in compliance with their fiduciary duties – even if the decision later turns out to have been inconsistent with the best interests of the corporation or its charitable purposes.

c) What is the liability of executive staff?

Tort liability is a significant source of potential liability for directors, officers, and other staff, and therefore it is highly recommended that charities obtain sufficient insurance coverage, including "D&O" (director and officer) policies. For directors and officers, a breach of fiduciary duties and other improper acts may be prosecuted by the state Attorney General. State law may provide additional protections for volunteer officers and directors who have acted consistently with their fiduciary duties.

For all insiders, self-dealing may be penalized by Internal Revenue Service.

d) Can the founder modify the standard of diligence for board members in the foundation's statutes?

Probably not; the standard of diligence could be raised by the Board, but not unilaterally by a founder.

e) Can board members be held civilly and/or criminally liable in the following cases?

	Yes	Probably yes	Unclear	Probably no	No
The foundation distributes money for a purpose which is a public benefit purpose but not accepted in the foundation's statutes.					x
The foundation loses its status of a tax benefit foundation (because one requirement in tax law was not fulfilled).				x	
The foundation loses money because a board member has acquired some stocks in a company which unexpectedly went bankrupt.			x		
The foundation sells immovable property to the spouse of a board member. The board member was unaware that the price was too low.			x		
The foundation sells immovable property to a third person. The board member was unaware that the price was too low.				x	

10. Are economic activities⁴ allowed (related/unrelated)? If so, is there a ceiling/limit on economic activities (related/unrelated)?

Yes, related economic activities, i.e. activities that directly further the charity's exempt purposes, are allowed and generally unlimited.

Unrelated economic activities are generally allowed as long as they are not more than an insubstantial part of the organization's overall activities, but the revenue from such activities may be taxable. If an activity is a trade or business that is regularly carried on and is not substantially related to the organization's exempt purposes, the activity will be subject to unrelated business income tax unless one of several exceptions applies. For example, income from royalties, rents, interest income, dividends, sales of capital assets, and certain other categories may be exempt from unrelated business income tax if certain criteria are met.

⁴ For the purposes of this profile economic activity can be understood as "trade or business activity involving the sale of goods and services". "Related" economic activity is in itself related to and supports the pursuance of the public benefit purpose of the foundation. According to the above, normal asset administration by foundations (including investment in bonds, shares, real estate) would not be considered as economic activity.

11. Are foundations permitted to be major shareholders?

Yes, charities may be major shareholders as long as the investment is prudent. However, under Internal Revenue Code Section 4943, private foundations have restrictions on their business holdings, which may not exceed certain thresholds.

12. Are there any rules/limitations in civil and/or in tax law regarding foundations' asset management? What, if any, types of investment are prohibited?

Most states have adopted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"), which applies rules regarding endowments, other restrictions on use of grants, and investments, to institutions holding funds for charitable purposes. Private foundations have restrictions on their ability to enter into investments that could jeopardize their ability to carry out their exempt purposes, and are prohibited from holding more than a certain threshold of any particular business.

13. Are foundations legally allowed to allocate grant funds towards furthering their public benefit purpose/programmes which (can) also generate income? (recoverable grants; low interest loans; equities)

Yes.

14. What are the requirements for an amendment of statutes/amendment of foundations purpose?

Under state law, an amendment typically requires board approval (and may require member approval if the corporation has members), and may require the approval of the state authority and/or grantors who granted funds under the prior charitable purpose restriction.

15. What are requirements with regard to reporting, accountability, auditing?

a) What type(s) of report must be produced?

- annual financial report: **If state law requires the procurement of independent audited financial statements, the charity will in most cases be required to submit such reports to the state.**
- annual activity report: **Not applicable.**
- public benefit/activity report: **Not applicable.**
- tax report/tax return,: **The Internal Revenue Service requires most charities to file an annual tax information statement detailing financial and operational activity, donors, and compensation amounts. For states with corporate income or franchise taxes, the charity will be required to file a similar information report.**
- other reports e.g. on 1% schemes): **Most states require annual filings from charities that engage in charitable solicitation within the state.**

b) Must all/any of the reports produced by the foundation be submitted to the supervisory authorities? If so, to which authorities (e.g. foundation authority, tax authority)?

Please see above for this information.

c) Are the reports checked/reviewed? By whom (supervisory/tax authorities)?

Annual tax information returns are reviewed by the Internal Revenue Service and state taxing authorities. Annual and biannual information statements are reviewed by state authorities.

d) Do any or all of the reports and/or accounts of foundations need to be made publicly available? If so, which reports and where (website, upon request)

Yes, federal tax returns and exemption application must be made available upon request. Some states post tax returns and audited financial statements on state websites. Donor information for public charities is not subject to public disclosure.

e) What are the legal requirements concerning external audit? Is external audit required by law for all foundations?

State law dictates whether an external audit is required; state law sometimes requires organizations above a stated revenue threshold to obtain an independent audit. For example, in California, entities with annual gross revenue at or above \$2,000,000 must obtain an external audit.

f) By whom should audits be undertaken? Do requirements/guidelines exist regarding international and national auditing agencies and standards?

Yes, state law usually specifies who (e.g., certified public accountants) may perform an independent audit.

16. Supervision (which authority – what measures / sanctions?)

a) Does the supervisory authority comprise of a public administrative body, a public independent body, a combination of a governmental body and a court, or a public body and an independent body?

The Internal Revenue Service is a federal regulatory agency. State supervisory authorities include the Secretary of State and Attorney General.

b) What is the extent of the supervision? Does the body review reports and make inquiries? Are public benefit organisations subject to inspection?

Charitable organizations are subject to audit, and their periodic reports are subject to review.

c) Is approval from the authority required for certain decisions of the Board of Directors?

Depending on the state, certain decisions such as dissolution, transfer of substantially all of the assets of the corporation, or merger, may be subject to the review and/or approval of the state authorities.

d) Is it mandatory to have a state supervisory official on the board?

No.

e) What enforcement measures are in place (including compliance measures and sanctions for non-compliance) concerning registrations, governance, reporting, and public benefit status?

Depending on the state, penalties for failure to comply with registration, governance, and reporting requirements may include fines or suspension of good standing (which may mean that the organization is not permitted to enter into contracts or otherwise conduct business).

17. When and how does a foundation dissolve?

Unless otherwise provided in its governance documents, a charity may dissolve at a time of its choosing, subject to procedures imposed by state law. Typically, the board of directors (and the members, if applicable) must first approve a plan of dissolution, after which the state regulatory body (such as the state's Attorney General) must either waive objections or affirmatively approve the dissolution before it may become effective. The corporation may dissolve after its obligations have been provided for or paid, and its net assets distributed according to the plan of dissolution.

18. Under what conditions does the civil law in your country recognise a foreign foundation?

The Internal Revenue Service will in some cases grant recognition to a foreign charitable organization.

19. Does the civil law in your country allow a foundation to conduct (some or all) activities (grant-making, operating, asset administration, fundraising) abroad? Is there any limitation?

Yes, a U.S. charity may conduct some or all of its activities abroad, subject to local law limitations.

II. Tax treatment of the foundation

1. What are the requirements to receive tax exemptions (pursuing public benefit purposes, non-distribution constraint, being resident in the country?). Is there a special approval process for receiving tax exemption? If so does the process have to be repeated every year?

To qualify for tax-exempt charitable status under United States federal tax law, an organization must satisfy the requirements of Section 501(c)(3) of the Internal Revenue Code, as further interpreted by the Income Tax Regulations. In plain English, an organization must satisfy the following six requirements to qualify as a tax-exempt charity:

- It must have an exempt purpose, such a religious, charitable, scientific, or educational.
- It must be organized exclusively for exempt purposes (governance documents).
- It must be operated primarily for those purposes.
- There must be no inurement - that is, no improper benefit to anyone in a position to control the charity or exert substantial influence over it.
- There must be no candidate activity - that is, no support or opposition to any candidate for public office.
- There must be no substantial reporting lobbying activity - that is, no substantial support or opposition to legislation.

Most charities must apply to the Internal Revenue Service (IRS) for recognition of tax-exempt status.

In some states in the United States, an organization must also qualify for tax exemption at the state level.

2. What are reporting/proof requirements to claim tax exemptions? What does the foundation have to submit to the authorities (statutes, financial reports, activity reports, other?)

An organization files a "Form 1023" with the IRS to claim exemption as a charity. The application involves completion of a lengthy form that includes questions about the charity's actual and planned activities; governance procedures; compensation policies; and the qualifications of, and relationships between, directors, officers, and key employees. Financial data and governing documents must also be provided. In order to remain exempt, most charities must file an annual report with the IRS on Form 990 or Form 990-PF.

3. Is specific reporting required for the use of state funds?

A public charity must report grants received from the government in a separate line item on Form 990. Charities receiving federal and state government grants typically have significant record keeping and reporting requirements to the grantor on their use of the grant funds.

4. Is there an obligation to report on donors and beneficiaries?

Yes, on Form 990, charities are required to provide information on both donors and beneficiaries (i.e., grantees).

5. Are there specific accounting rules for foundations?

Yes. In the United States, the Financial Accounting Standards Board (FASB) establishes standards of financial accounting that govern the preparation of financial reports. Among other things, FASB issues standards specific to not-for-profit entities.

6. Is there a statutory definition in the civil law (foundation law, trust law) of your country what a public benefit purpose (charitable purpose) is? If yes, please give us the definition.

Apart from federal tax law (see below), any definition of "charity" would be found at the state level. For example, in California for trust law purposes, charitable purposes include the relief of poverty, the advancement of education or religion, the promotion of health, the promotion of a governmental purpose, or any other purpose the achievement of which is beneficial to the community. (California Probate Code Section 18502 definition, tracking Restatement (Third) of Trusts, Section 28).

7. Is there a statutory definition in the tax law of your country of what a public benefit purpose is? If yes, please give us the definition.

Section 501(c)(3) of the Internal Revenue Code, which defines tax-exempt charities for federal tax

purposes, includes the following list of charitable purposes: “[R]eligious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition [. . .] or for the prevention of cruelty to children or animals”. Treasury Regulations further elaborate on these different categories.

8. Please indicate whether the following purposes would or would not be accepted for tax privileges in your country:

Public benefit purpose	Accepted in tax law (for tax privileges)			
	Yes	Probably yes	Probably no	No
Arts, culture or historical preservation	x			
Environmental protection	x			
Civil or human rights	x			
Elimination of discrimination based on gender, race, ethnicity, religion, disability, sexual orientation or any other legally prescribed form of discrimination	x			
Social welfare, including prevention or relief of poverty	x			
Humanitarian or disaster relief	x			
Development aid and development cooperation		x		
Assistance to refugees or immigrants		x		
Protection of, and support for, children, youth or elderly	x			
Assistance to, or protection of, people with disabilities	x			
Protection of animals		x		
Science, research and innovation		x		
Education and training	x			
European and international understanding		x		
Health, well-being and medical care		x		
Consumer protection		x		
Assistance to, or protection of vulnerable and disadvantaged persons	x			
Amateur sports			x	
Infrastructure support for public benefit purpose organisations		x	x	
<i>Other – please list other purposes accepted in tax law for tax privileges in your country</i>				

9. Support of “the public at large”

a) Do the activities of a tax-exempt foundation generally have to benefit “the public at large”?

The activities of a charitable organization do not have to benefit the public at large, but can focus on a particular segment of the population (such as providing scholarships for students at a particular college). However, the class of potential beneficiaries must be sufficiently large. A well-known quote puts it this way: “Charity begins where certainty in beneficiaries ends, for it is the uncertainty of the objects and not the mode of relieving them which forms the essential element of charity.” (See *S.E. Thompson v. Comm’r*, 2 T.C. 441 (1943)). Or put another way, to be charitable, trusts (and other charities) must “be for the benefit of an indefinite number of persons; for if all the beneficiaries are personally designated, the trust lacks the essential element of indefiniteness, which is one characteristic of a legal charity.” *Russell v. Allen*, 107 U.S. 163, 167 (1883).

b) If yes, can a tax-exempt foundation support a small number of disadvantaged/underprivileged individuals?

Yes, if the number of individuals is large enough to constitute an indefinite number of potential recipients.

Examples: Do the following purposes promote the public at large?

	Yes	Probably yes	Unclear	Probably no	No
For benefit of the inhabitants of a city with 1,000,000 inhabitants	x				
For benefit of the inhabitants of a village with 10,000 inhabitants	x				
For benefit of the employees of a company			x		
For benefit of the members of a family					x
For benefit of the students of a university	x				
Award for the best student of a university	x				

10. Non-Distribution Constraint

a) Does a tax-exempt foundation generally have to follow a “non-distribution constraint”⁵ which forbids any financial support of the foundation board, staff, etc.?

Federal tax law does not provide an outright prohibition on such distributions. However, a variety of safeguards are required to ensure that any such distributions are part of the valid charitable programs of the charity, and for “private foundations”, a particular type of U.S. charity, many, but not all, financial transactions with a certain group of charity insiders is outright prohibited.

b) What happens with the foundation’s assets in case of dissolution?

For federal tax law purposes, charities with Section 501(c)(3) tax-exempt status are required to have their assets go to one or more other charitable organizations, or to otherwise ensure that their assets will be used for charitable purposes, upon dissolution. Depending on the type of legal entity (corporation, trust, etc), and the state of formation, state law rules also typically provide rules about use of assets upon dissolution, and procedures for dissolving the entity.

11. “Altruistic” Element

a) Is remuneration of board members allowed in civil law and in tax law? If remuneration is allowed, are there any limits in civil law and/or in tax law?

Generally speaking, federal tax law permits reasonable remuneration of board members for services provided to the charity. Different states have different laws that apply to charities that may further vary depending on the form of legal entity. Generally speaking, in many contexts reasonable remuneration is permitted. However, it is important to check the laws for each state. For example, in California, in a non-profit public benefit corporation, not more than 49 percent of the governing body may be composed of “interested” directors, which definition hinges on compensation of directors and their family members. However, compensation paid to a director as a director (such as a flat fee payment for attending a board meeting) is permitted for the entire board.

b) Does tax law allow a donor/funder to receive some type of benefit in return for a donation? (E.g. postcards, free tickets for a concert)

Generally speaking, a donor is permitted to receive a return benefit in exchange for a donation; however, the deduction permitted for the donation is generally reduced by the fair market value of the return benefit. Certain return benefits qualify as insubstantial benefits and do not reduce the deduction.

⁵ For the purposes of this profile, a non-distribution constraint implies that any transactions/benefits to third parties going beyond reasonable compensation for services rendered are prohibited (such as unreasonable board remuneration or excessive payments to service deliverers) except where transactions/benefits provided are part of the direct promotion of the public benefit purpose.

c) Is there a maximum amount that can be spent on office/administration costs in civil law and in tax law?

No, there are no such outright limits.

If yes, how are “administration costs” defined? Please indicate which of the following types of expenditures would/would not be considered as “administration costs”:

Not applicable, see above.

- Personnel costs (staff salaries/payroll costs)
- Board remuneration
- Costs of external audit
- Other legal/accounting costs
- General office overheads (rent/mortgage payments, utilities, office materials, computers, telecommunications, postage)
- Insurance
- Publicity and promotion of the foundation (e.g. website, printed promotional materials)
- Asset administration costs
- In the case of an operating foundation – costs related to programmes/institutions run by the foundation
- Costs related to fundraising

12. Hybrid Structures (elements of private benefit in public benefit foundations)

a) Does the civil law of your country accept the following provisions/activities of a public benefit foundation?

Given civil law is dictated by the state law applicable to a particular legal entity, the following response is for a California non-profit public benefit corporation.

	Yes	Probably yes	Unclear	Probably no	No
The founder restricts the use of the endowment by specifying that the foundation is required to maintain the founder, his spouse and descendants.					X
The founder retains a beneficial reversionary interest in the capital of a property or other asset for his own continuing use.					X
The gift is of only the <i>freehold reversion</i> (residuary interest) in a residence that is subject to an existing lease (for a term of years, or even for life) in favor of the founder (or another member of her/his family) as tenant.	X				
A foundation distributes a (small) part of its income to the founder or his family.					X

b) Does the tax law of your country accept the following provisions/activities of a tax-exempt foundation?

	Yes	Probably yes	Unclear	Probably no	No
The founder restricts the use of the endowment by specifying that the foundation is required to maintain the founder, his spouse and descendants.					X
The founder retains a beneficial <i>reversionary</i> interest in the capital of a property or other asset to retain for its own continuing use.					X
The gift is of only the <i>freehold reversion</i> (residuary interest) in a residence that is subject to an existing lease (for a term of years, or even for life) in favor of the founder (or another member of her/his family) as tenant.	X				
A foundation distributes a (small) part of its income to the founder or his family.					X

13. Distributions and Timely Disbursement

a) Are foundations allowed to spend down their capital?

Yes, unless the donor giving that capital prohibited the spend down at the time of the donation, or the context of the donation in other ways imposed that prohibition on the spending of capital (such as the charity soliciting the donors to contribute to an endowment).

b) Are they allowed to be set up for a limited period of time only? If so, is there a minimum length of time for which the foundation must exist?

Yes, charities are permitted to be set up for a limited period of time. No, there is no minimum length of time.

c) Does the civil law and/or the tax law of your country require a foundation to spend its income (or a certain amount of the income) within a certain period of time, e.g. within the next financial year? If so, is there a specific amount/percentage of the income that must be spent within this time? Which resources would be considered as income? E.g. would donations/contributions designated as being for building up the endowment be included in /excluded from the income to be spent? What expenditures would count towards the disbursement of income (e.g. would administration costs be included/excluded)?

No.

d) Does the civil law and/or the tax law of your country require a foundation to spend a percentage of its overall assets in the form of a “pay-out rule”?

As noted in the introduction to this report, U.S. federal tax law distinguishes between two types of charities, public charities and private foundations. Private foundations, but not public charities, have a “minimum distribution requirement.” Simply put, Section 4942 of the Internal Revenue Code

requires a private foundation to distribute each year, for charitable purposes, an amount equivalent to 5% of the fair market value of the foundation's non-charitable assets.

Example: Does the civil law of your country accept the following activities of a public benefit foundation?

	Yes	Probably yes	Unclear	Probably no	No
A foundation accumulates its income for 5 years, only in the 6 th year are there distributions for the public benefit purpose of the foundation.		X			

Example: Does the tax law of your country accept the following activities of a public benefit foundation?

For public charities, there is no pay-out rule. For private foundations, see example below.

	Yes	Probably yes	Unclear	Probably no	No
A foundation accumulates its income for 5 years, only in the 6 th year are there distributions for the public benefit purpose of the foundation.				X	

14. Does activity abroad put the tax-exempt status at risk?

No, American charities may conduct charitable activities outside of the United States.

15. Are there any civil and/or tax law rules regulating cross-border grants by a foundation? If yes, please provide a description of the requirements the foundation must fulfil in such cases.

Private foundations are subject to special regulations that are aimed to ensure that private foundation grants to foreign entities are used for charitable purposes. If a private foundation grants funds to a foreign entity, it must either exercise expenditure responsibility or determine that the foreign organization is the foreign equivalent of a domestic public charity. See IRC Section 4945 and accompanying Regulations. Public charity grantmakers, however, are not subject to these rules.

16. Income tax treatment

How are the following types of income treated for income tax purposes?

Grants and donations

Generally, grants and donations are not taxed to charities.

Investment income (asset administration)

- Interest from fixed rate bonds: Not taxed.

- Equities: Not taxed.

- Income from leasing of a property that belongs to the foundation: **Not taxed.**

For the above examples, an important except applies if the asset generating the income was acquired with debt financing (see Internal Revenue Code Section 514).

Economic activities related/unrelated)

- Income from running a hospital/museum/opera: **Probably not taxed.**

- Income from producing/selling books (e.g. art books sold by a cultural foundation): **Income from sale of books related to charity's purposes is not taxed.**

- Income from running a bookshop inside a museum/opera run by the foundation:): **Income from sale of books related to charity's purposes is not taxed.**

- Income from running a café in the hospital/museum run by the foundation: **Depends on how café is operated. If it is operated for the convenience of hospital/museum users and visitors, the income is not taxed.**

- Income from selling T-shirts (activity not related to the pursuance of the public benefit purpose): **Income is taxed.**

- Income from intellectual property (e.g. royalties and licence fees): **Income is probably not taxed.**

Income deriving from grant expenditure towards public benefit purpose/programme activities (such as loans, guarantees, equities)?

Generally not taxed.

Is major shareholding considered as an economic activity and taxed accordingly?

No, generally income from shareholdings, such as dividends, are not taxed.

17. Are capital gains subject to tax? If so, are they taxed as income or liable to a separate tax?

Generally, charities are not taxed on capital gains (unless the property generating the capital gains was acquired with debt financing, as defined in Internal Revenue Code Section 514).

18. Does any kind of value added tax (VAT) refund scheme for the irrecoverable VAT costs of public-benefit foundations exist in your country?

No.

19. Is capital tax levied on the value of assets, where applicable?

No.

20. Are there taxes on the transfer of assets by foundations?

No, unless in narrow circumstances a capital gains tax might be imposed under the unrelated business taxable income rules.

21. Are there any other taxes to which public-benefit foundations are subject there (e.g. real property tax)?

Yes, a variety of taxes may be imposed on a charity, on a state by state level, including state level income and franchise taxes, property taxes, and sales taxes.

22. Can a foreign foundation get the same tax benefits as a national foundation according to the wording of the tax law in your country? If yes, under what conditions_– if they have to fulfil exactly the same requirements as local based public benefit foundations, please refer to above but indicate which documents need to be provided and translated:

Foreign charities may apply for tax-exempt status on income earned in the United States in the same way that domestic organizations apply for exempt status. The Form 1023 tax exemption application must be prepared in English, and an English translation is required if governing documents are in any other language. In the Form 1023 instructions, the IRS indicates that it may ask an applicant to provide English translations of foreign language publications submitted with the Form 1023. Financial information must be reported in U.S. dollars, with the conversion rate specified. However, gaining tax exemption in the United States does not mean that U.S. donors to the foreign charity can get a tax deduction for their contributions to the charity. With the exception of certain donations governed by specific tax treaties, generally speaking United States donors will only get a tax deduction for donations made to charities formed in the United States.

- Statutes (translation required?): **Need to be provided and translated**
- Last annual financial report (translation required?): **Financial information needs to be provided in U. S. currency**
- Documents providing evidence for certain tax law requirements e.g. that income was actually spent for public benefit purposes, which may not be required by the organisation's country of seat but are required according to the legislation of the country from which tax benefits are sought?: **Form 1023 asks for information on income and expenses in a certain format.**
- Other?

23. Does your country apply withholding tax to the income from local investments held by domestic and/or foreign-based foundations? If so, can domestic or foreign-based foundations reclaim all or part of the withholding tax under domestic law?⁶

US public charities and private foundations are not generally subject to federal income tax or withholding tax on their US investments, but private foundations are liable to a separate federal excise tax on their annual investment income at the rate of 1%-2%.

Foreign public charities and private foundations are liable to withholding tax on their US source investment income. The general rate of withholding tax on dividend, interest and royalty income is 30% but this reduced to 4% for dividends paid to foreign private foundations. These rates may be

⁶ The information in response to this question was provided by Paul Bater, The Wellcome Trust.

reduced by an applicable tax treaty. To the extent that the tax withheld exceeds the annual tax liability of the foreign charity (for example, if the foreign charity has been determined by the Internal Revenue Service to be a tax-exempt organisation) the foreign charity can reclaim the excess withholding tax when it files its annual federal tax return.

III. Tax treatment of donors of public benefit foundations

1. System of tax credit⁷ or tax deduction⁸?

In the United States, tax deductions but not tax credits are available for donors to Section 501(c)(3) charities.

2. Tax treatment of individual donors

a) What tax relief is provided for individual donors? Is there a minimum and/or a ceiling to a contribution on which tax incentives can be claimed?

The tax relief available greatly depends on the personal tax circumstances of the individual donor. First, only “itemizers,” or individuals who opt to separately list each of their deductible expenses, are eligible to take charitable contribution deductions. Most individual U.S. taxpayers are not itemizers.

For itemizers, there is no minimum contribution level, but contributions are limited to a certain percentage of the individual’s adjusted gross income, which varies anywhere from 20% to 50%, depending on the type of gift and whether the recipient charity is a private foundation or a public charity.

Contributions not used in a tax year may be carried forward for use in the succeeding five years.

b) Which assets qualify for tax deductibility?

Most assets will qualify for tax deductibility, including cash, stock, real estate, and even intellectual property. Because the amount of the deduction can vary greatly depending on the type of gift and whether the recipient is a private foundation or a public charity, it is critical that donors receive correct advice before giving. For example, real estate, an asset which tends to appreciate over time, is deductible only at basis if given to a private foundation, but at fair market value (usually much greater than basis) if given to a public charity.

The value of services donated to an organization is not eligible to be deductible.

⁷ For the purposes of this profile tax credit can be defined as an amount that can be deducted from the actual tax to be paid (reduction in amount of tax paid)

⁸ For the purposes of this profile tax deduction can be defined as a reduction in the gross amount on which tax is calculated (reduction in taxable income/tax base)

3. Tax treatment of corporate donors

a) What tax relief is provided for corporate donors? Is there a minimum and/or a ceiling to a contribution on which tax incentives can be claimed?

Corporations may deduct charitable contributions to most Section 501(c)(3) corporations. There is no minimum contribution level, but contributions are limited to 10% of a corporation's adjusted gross income. As with individuals, unused amounts may be carried forward for up to five years.

In some cases, a corporation may be able to treat a payment to a charity as a business expense fully deductible under Internal Revenue Code Section 162, rather than a charitable deduction subject to the 10% limit.

Corporate donors have the additional restriction that gifts to non-corporations recognized as Section 501(c)(3) entities (such as trusts), must be used in the United States for the gift to be deductible.

b) Which assets qualify for tax deductibility?

Most assets will qualify for tax deductibility, including cash, stock, real estate, intellectual property, and inventory. As with individuals, because the amount of the deduction can vary greatly depending on the type of gift and whether it is given to a private foundation or a public charity, it is important that a corporate donor receive correct advice before giving.

The value of services donated to an organization is not eligible to be deductible.

4. Tax treatment of donations to non-resident public-benefit foundations – do donors get the same tax incentive?

Generally, U.S. donors only receive a deduction for gifts to Section 501(c)(3) entities that are organized in the United States. Select tax treaties with other countries provide limited exceptions.

5. Other frameworks such as percentage law systems

Not applicable.

6. What are the requirements that the donor must fulfil/ information they must provide in order to claim tax benefits?

Generally none, although the donor must retain appropriate substantiation of the gift on file. For most gifts, this is a receipt. Additional paperwork (Form 8283) is required for gifts of \$500 or more. For gifts of \$5000 and more that are not cash and not publicly-traded securities, the donor must obtain an appraisal meeting detailed technical requirements set forth in Treasury Regulations.

What information do donors have to provide to their tax authority in order receive tax incentives for their donation (e.g. submitting details on the organisation they support: statutes, annual financial report, documents providing evidence for certain tax law requirements e.g. that income was actually spent for public benefit purposes?)?

Donors need only obtain and retain appropriate substantiation, as described above.

7. Are there any different or additional requirements to be fulfilled when a donor is giving to a foreign-based foundation?

As described above, with limited exceptions, U.S. donors may not receive deductions for gifts directly to non-U.S. charities. In some cases, it is possible for U.S. donors to give to a U.S. charity that in turn donates to a foreign charity, but for the donation to be deductible to the donor, the U.S. charity must have “discretion and control” over the gift, or the ability to make the gift elsewhere. In this way, the donation is truly to the U.S. entity, and the donor takes the (typically small) risk that the donation may not be re-granted to the intended non-U.S. entity.

What information do donors to foreign-based organisations have to provide in order receive tax incentives for their donation (e.g. Statutes (translation required)? Annual financial report (translation required)? Documents providing evidence for certain tax law requirements e.g. that income was actually spent for public benefit purposes?)?

See above; in general, U.S. donors may not receive deductions for direct gifts to non-U.S. charities.

IV. Tax treatment of the beneficiary (receiving a grant or other benefit from a foundation)

1. Individuals

Generally, grants and gifts to individual beneficiaries do constitute taxable income to the individual, but there are exceptions, including certain prizes and awards, certain scholarship grants and certain disaster relief payments.

2. Legal entities

In the typical case, the entity recipient of a gift is a Section 501(c)(3) charity or other tax-exempt organization, which does not generally pay tax on income in any case. In the less common instance where a taxable organization receives a grant, this is typically taxable income.

3. Are there any different or additional requirements that must be fulfilled by a beneficiary receiving funding from abroad?

No.

V. Gift and inheritance tax

1. Does gift and inheritance tax/transfer tax exist in your country and if yes who has to pay the tax in the case of a donation/legacy to a public-benefit organisation (the donor or the recipient organisation)?

Yes, the U.S. has a system of gift and inheritance tax (the latter is called "estate" tax), in which an individual is taxed on gifts made during life and the value of his or her estate at death.

2. What are the tax rates? Is there a preferential system for PBO's? Which PBO's qualify? Is there a difference according to the region or the legal status of the PBO?

The gift and estate tax in the U.S. is extremely complicated, but gifts and bequests to entities exempt under Section 501(c)(3) are deductible from both gift and estate tax.

3. Is there a threshold (non-taxable amount) from gift and inheritance tax for donations/legacies to public-benefit organisations?

No. Gifts and bequests to entities exempt under Section 501(c)(3) are deductible without limit.

4. Is there a legal part of the estate that is reserved for certain protected heirs and which a donor cannot give to third parties?

No.

5. What is the tax treatment (inheritance and gift tax) of legacies to non-resident public benefit foundations?

Gifts and bequests to non-U.S. organizations may be deductible for gift and estate tax purposes, but to do so, the recipient organization must meet very specific requirements.

VI. Trends and developments

1. Are there current discussions about the question of whether cross-border activities of foundations or other non-profit organisations and their donors are protected by the fundamental freedoms of the EC Treaty? Have there been any changes to your country's legislation, resulting from the Persche, Stauffer, Missionswerk or other relevant ECJ judgments, or are changes being discussed?

No, not of which the authors are aware.

2. Has the fight against terrorism and financial crime led to the introduction in recent years of new laws / rules affecting the foundation sector (e.g. implementation of EU Anti Money Laundering Directive, or reactions to recommendations of the Financial Action Task Force)?

Yes. Since September 11, 2001, there has been an increased focus in the U.S. regarding the

possible use of funds, charitable or not, for terrorist purposes, of which the most prominent examples are the U.S. Patriot Act and Executive Order 13224. As a result, entities supporting entities deemed by the U.S. government to be engaged in terrorism may have their assets frozen, and penalties for knowingly providing material support for terrorism have increased.

3. Are there any other recent trends or developments affecting the legal and fiscal environment for public benefit foundations in your country?

As noted in the prior question, since September 11, 2001, there has been increased concern in the U.S. regarding use of charitable funds for terrorism. Another important trend is the growth of the social enterprise movement, occurring at the intersection of the business and non-profit sectors, in which business and market-based approaches are used to solve social problems, or where benefits to society are sought simultaneously with financial benefits.

4. Public fundraising

Are there any specific laws that regulate fundraising and do they affect foundations?

Yes. In the United States, every local level of government (city, county, and state) has the ability to make laws governing the solicitation of charitable contributions. While some choose not to regulate, a foundation engaging in any of the following activities should check the city, county and states in which it is doing business and where donors solicited are located: soliciting contributions, working with a paid fundraiser or other professional to plan fundraising activity, and partnering with a for-profit to represent that the sale of a good or use of a service will result in a donation to charity (so-called commercial co-venturing).

Useful contacts

Please add names and contact details of persons who may be contacted for queries regarding the information in this profile or for further details of the legal and fiscal environment for foundations in your country.

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Selected bibliography

Please list here any books/articles which provide further information on the any of the topics discussed in the profile. Links to online articles/resources are also appreciated

USEFUL WEBSITES

- National Center on Philanthropy and the Law, NYU School of Law, maintains an excellent, searchable bibliography at <http://ncpl.law.nyu.edu/ncplsearch>
- Council on Foundations, www.cof.org
- The Foundation Center, www.foundationcenter.org
- Independent Sector, www.independentsector.org
- BoardSource, www.boardsource.org/eweb/
- GuideStar, www.guidestar.org
- Adler & Colvin Resources Site, www.adlercolvin.com

GENERAL

The Rules of the Road, by Betsy Buchalter Adler, Ingrid Mittermaier, and David Levitt (Council on Foundations, Inc., 2nd ed., 2012); www.cof.org.

IRS MATERIALS

IRS Publications and Forms are available from the IRS; www.irs.gov/charities.

Charitable Contributions Deductions (IRS Publication 526)

Tax-Exempt Status for Your Organization (IRS Publication 557)

Determining the Value of Donated Property (IRS Publication 561)

Tax on Unrelated Business Income of Exempt Organizations (IRS Publication 598)

Charitable Contributions: Substantiation and Disclosure Requirements (IRS Publication 1771)

Compliance Guide for 501(c)(3) Public Charities (IRS Publication 4221-PC)

Public Inspection of Tax Exempt Application and Annual Information Returns (IRS Notice 88-120, 1988-2 C.B. 454)

Deductibility of Admission Fee for Fundraising Events (Revenue Ruling 67-246, 1967-2 C.B. 104)

Education and Advocacy (Revenue Procedure 86-43, 1986-2 C.B. 729)

Return Benefit Doctrine (Revenue Procedures 90-12, 1990-1 C.B. 471, and Revenue Procedure 92 49, 1992-1 C.B. 987)

Filing Requirements for Non-Cash Contributions (IRS Announcement 90-25, 1990-8 I.R.B. 25)

The IRS also maintains an interactive web-based training for small and mid-sized exempt organizations at <http://www.stayexempt.org/> entitled Stay Exempt -Tax Basics for 501(c)(3)s.

About the EFC Legal and Fiscal Country profiles

This profile is part of a series of profiles of the legal and fiscal environments for foundations in 42 different countries across the wider Europe, as well as some countries in other world regions. The aim of these profiles is to paint a picture of the current operating environment for foundations in these countries to better understand the legislative landscape foundations inhabit. The profiles are produced in collaboration with foundations, legal experts, and associations in each country. Each profile is written by the national-level expert. A comparative overview of the country profiles from wider Europe can be downloaded from the EFC website: “Comparative Highlights of Foundation Laws: The Operating Environment for Foundations in Europe.”

www.efc.be

About the European Foundation Centre

The European Foundation Centre, founded in 1989, is an international membership association representing public-benefit foundations and corporate funders active in philanthropy in Europe, and beyond. The EFC develops and pursues activities in line with its four key objectives: creating an enabling legal and fiscal environment; documenting the foundation landscape; building the capacity of foundation professionals; and promoting collaboration, both among foundations and between foundations and other actors. Emphasising transparency and best practice, all members sign up to and uphold the EFC Principles of Good Practice