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Tax & Legal Perspecta

'If you do what you always did, you will get what you always got' – Albert Einstein

Enlarging the Space for international philanthropy

Removing obstacles for international philanthropy – a never ending story?

1.Introduction

The Donors and Foundations Networks in Europe (DAFNE) and the European Foundation Centre (EFC) have commissioned Dr. Oonagh Breen from the UCD Sutherland School of Law in Dublin to publish a report on the regulatory and political challenges philanthropy is facing and to elaborate ways forward that European donors and foundations can apply to work jointly with EU institutions and national governments to resolve the still existing obstacles for international philanthropy within Europe[1]. The Press Release on this report looks very exciting where it promises to deliver possible ways for facilitate philanthropy across Europe.

Since I have spent my PhD on this theme in an international context and the conclusions of my research and thesis 'how to resolve international obstacles for international philanthropy'[2] appear to remain very actual in the majority of European jurisdictions, my attention was caught immediately.

The report however disappointed me, in the sense that it repeated a lot of the mistakes and 'lessons learnt' in the past and reiterated to a large extent on earlier reflections from the perspective of a *top down* policy view by the respective bodies of the European Union.

The title of the Report refers to the trend that internationally has been framed as 'the Closing Space for Civil Society', pointing at the increased legal restrictions that governments around the world impose on the registration, operation and funding of non-governmental organisations (NGO's) and public interest pursuing organizations in general. These restrictions vary from fiscal and administrative regulations such as (overly) restrictive counter-terrorism financing measures and international expenditure control at one hand to politically inspired undemocratic restrictions on the flow of charitable funds across borders in countries like India, Mexico and China[3] and in Europe also in Hungary and Poland on the other hand. The drivers behind the last mentioned, political inspired restrictions include the global loss of democratic momentum, the rising power of political systems and leaders opposed to universal values, and the fear of many power-holders of the capacity of independent civil society to challenge and hold to account entrenched regimes[4].

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[1] https://dafne-online.eu/news/new-study-enlarging-the-space-for-european-philanthropy/

[2] I.A. Koele, International Taxation of Philanthropy, International Bureau of Fiscal Documentation 2007, : https://www.ibfd.org/IBFD-Products/International-Taxation-Philanthropy.

[3] www.cof.org Closing Space for civil society & philanthropy for an overview.

[4] Ariadne/ EFC/International Human Rights Funders Group, challenging the closing Space for Civil Society, 2012.

Framing all these very distinctive drivers as 'the closing space' for international philanthropy is in my view a rather dangerous thing to do, since it stipulates these factors as a 'trend' which implies that nobody really is accountable or responsible for each and individual measure – following the trend is a typical and seemingly innocent human behaviour. The recent developments in Hungary are political in nature and hopefully, the legal attack on independent non-profit organizations receiving funds from foreign sources under the 'Foreign Agents' legislation cannot be viewed as part of an ongoing trend of reducing democratic freedom. In any respect, this new law is in clear contradiction with the existing EU Treaty provisions and accordingly, the European Commission has launched a so-called infringement procedure against Hungary as per 13 July 2017 whilst simultaneously, the 'nuclear option' of article 7 of the Treaty on the European Union on withdrawing membership of the EU has been initiated.

The DAFNE/EFC Report basically refers to the first-mentioned category of drivers, the fiscal and administrative restrictions. It points basically at two categories of restrictions, those following from anti-terrorism financing regulations and those from discriminatory tax treatments. However, as I will explain hereunder, in this area there is in my view not a trend to make things more burdensome or where governments indeed maintain other points of view or arguments than before. The solutions to overcome the existing barriers do not have to come from 'top-down' legalistic innovations but instead, should work on the underlying rationale of these restrictions and obstacles.

2. Anti-terrorist financing

The Financial Action Task Force (FATF) – the premier intergovernmental body responsible for developing and promoting global policies to combat money laundering and terrorism financing – adopted a series of Special Recommendations specific to terrorist financing in 2002. These included the Recommendation that countries review the adequacy of laws and regulations that relate to non-profit entities, as these are particularly vulnerable for the financing of terrorism[5].

In 2013, the FATF began bilateral discussions with a group of interested non-profits that raised the awareness of non-profit concerns regarding the overly general implementation of R8 at national, regional and global levels. This has led to more refined approaches, such as a risk-based approach and resulting in the 2016 revision of Recommendation VIII, retracting the general claim that the non-profit sector is 'particularly vulnerable' to terrorist abuse. Countries are now encouraged to review the adequacy of laws and regulations that relate to non-profit organisations which the country has identified as being vulnerable to terrorist financing abuse. Countries should apply focused and proportionate measures, in line with the risk-based approach, to such non-profit organisations to protect them from terrorist financing abuse.

Furthermore, the European Commission published in 2017 the Supra National Risk Assessment Report which does recommend Member States to ensure appropriate non-profits coverage in their national risk assessments as part of their risk mitigation measures but does not propose any new European regulation in this field.

In my dissertation, I found the recommendations of the FATF, if followed up, very useful for the effective resolution of the obstacles for international philanthropy. Especially the more practical suggestions formulated already back in 2002 by FATF on potential measures to be enacted by legislators were considered most welcome since these measures were very similar to the due diligence procedures in the context of responsible tax relief of international flows of philanthropy[6].

[5] http://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-recommendations.html
[6] Chapter 7, Appraisal and conclusions, p. 371 ff.

According to the FATF recommendations countries should have practical measures in place that require non-profit organizations, for example, to:

a) Have appropriate controls to ensure that all funds are fully accounted for and are spent in a manner that is consistent with the purpose and objectives of the NPO's stated activities;
b) Follow a rule to know your beneficiaries and associate NPOs. This means that an NPO must take its best effort to confirm the identity, credentials and good standing of its beneficiaries and associate NPOs.
c) Maintain, for at least five years, and make available to appropriate authorities, records of domestic and international transactions that are sufficiently detailed to verify that funds have been spent in a manner consistent with the purpose and objectives of the organization.

Already in 2007 and since then, I found that the importance of accurate due diligence procedures – which is critical to resolving obstacles to international philanthropy and still underdeveloped - is enhanced by the new threat of anti-terrorism measures.

3. Cross border tax obstacles and solutions

The DAFNE/EFC Report describes the ongoing fiscal and legal barriers to cross border philanthropy as arising from incompatible and EU law conflicting laws and practices. It highlights the lack of publicly available information around 'comparability processes' operated by Member State tax authorities when faced with cross border philanthropy as one of the main problems to date. Accordingly, it recommends the creation of a website resource and the pooling of knowledge on tax authority procedures in each jurisdiction.

On the failure of the European proposal for the European Foundation the Report states that:

'*It would be fair to say that the EU Treaties have made it difficult to date to develop bespoke legal vehicles to advance philanthropy per se on a pan-European basis. Civil law and common law differences matter when it comes to drafting enabling regulation for philanthropy. Although there is EU level consensus and recognition of the substantial contribution made by institutionalised philanthropy to European goals and the important role played by public benefit foundations in enhancing and facilitating a more active involvement of citizens and civil society in the European project, harnessing that macro consensus and turning it into unanimous agreement on new legal tools to support philanthropy is difficult. The different philanthropic traditions that co-exist across the 28 EU Member States mean that there is no singled accepted definition of philanthropy, or legal or reporting structure. Moreover, differences in history and culture, economic and political conditions, and taxation rules between not only common law and civil law member states but also between states of the same legal tradition make the promulgation of non-profit regulation extremely complex and challenging in the absence of a more enabling legal basis that article 352 of the EU Treaty currently provides'* (p. 17, Report Enlarging the Space for European Philanthropy).

It is remarkable to read this anno 2018, whereas in 2007 the conclusions of my comparative research on legal and tax systems on philanthropic organizations has shown that the non-discriminatory treatment of non-profit organizations does not relate to conceptual differences such as historical and cultural, political or regulatory and legislative conditions between the jurisdictions, but can be explained exclusively by the category of anti-abuse rationales[7].

[7] Id., International Taxation of Philanthropy, Chapter 7.1. The method of substantiation of these outlines is referred to as comparative law as explained by Frankenberg, whereby the existing terms

The *only rationale* for the existence of landlocked provisions in tax laws relating to cross border philanthropic transfers is found in the legitimate concern regarding (1) control on the proper expenditure of the funds abroad in accordance with public purposes and (2) the maintenance of the effectivity of specific requirements for tax relief on foreign philanthropic organizations.

Accordingly, it is a very poor excuse to say that the differences between legal systems and cultures justify or at least maintain a discriminatory treatment. Already back in 1969 J. Van Hoorn already had found in a report of the International Fiscal Association on the topic that '*a critical examination of the criteria and arguments used for a restrictive application of tax concessions seems to provide a sufficient reason to state that there is hardly an objection to a removal of such obstacles. It is necessary, however, to establish several rules to make a removal of the obstacles possible in practice*'[8].

When the European Commission launched a Feasibility Study on the European Foundation Statute in 2009, it calculated the cost of barriers to cross border activities of European foundations to be at least EUR 100 million per year and that the European Foundation State was suggested as the preferable policy option to address cross border barriers. The European Foundation Statute expected the European jurisdictions to automatically recognize the tax-privileged status of a philanthropic organization established under a foreign statutory law, without substantiating the logic of this consequence. It is unrealistic to expect states to automatically recognize the tax privileged status of a philanthropic organization established under a foreign statutory law as to do so would overrule the states' tax sovereignty over an important tax matter. Since extensive commentaries of this kind were published in reaction to the Feasibility Study[9], it should not have come as a surprise that the proposal for the European Foundation was rejected by a number of member states.

In all the discussions and reports on resolving the problem of landlocked provisions and discrimination against foreign philanthropic organization, little attention has been paid by the policy makers to the legitimate concern of states to effectively control cross border philanthropic flows of money. When states open their borders for cross border philanthropy without considering measures to effectively control the ultimate destination of the funds, this can easily lead to abuse of the charitable status, which ultimately may be disadvantageous for the philanthropic sector as a whole.

The European Commission has undertaken a very active approach during the last decade regarding discriminatory tax treatment of comparable foreign charitable bodies. It has systematically initiated infringement procedures against member states that have landlocked elements in their tax legislation regarding philanthropic organizations. Where some jurisdictions have completely foregone their discriminatory tax treatment on non-profit organizations (like Luxembourg and the Netherlands) others have imposed new requirements that equally apply to domestic and foreign organizations (hence terminating any discriminatory treatment), but in practice make it difficult for foreign non-profit organizations to benefit from tax privileges. The DAFNE/EFC report mentions that '*the difficulty with this incremental approach (*of the European Commission, IAK*) is that the resulting structure depends greatly upon the will of the interpreting Member States to assist such*

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and perspective on law are not taken for granted but rather, openness to a radical re-evaluation of the domestic legal consciousness is starting point.

[8] IFA Cahier Volume LIVb, 'The possibilities and disadvantages of extending national tax reduction measures, if any, to foreign scientific, educational or charitable institutions'. See I.A. Koele, International Taxation of Philanthropy, Chapter 1.3 Historic attempts to resolve the landlock, p. 13 ff.

[9] See I.A. Koele, How Will International Philanthropy Be Freed from Landlocked Tax Barriers ?, European Taxation September 2010, p. 409 – 418.

organisations. (…) Some member states employ an opaque, oblique or an expressly onerous set of criteria for determining comparability, the effect of which is to restrict the fundamental freedoms of the non-domestic philanthropic organization. '

To put it in other words: there are willing and unwilling jurisdictions. The willing jurisdictions have created their own system of control and supervision, albeit this may or should be ameliorated also in light of the paradigm of anti-terrorism financing. In the Netherlands, for example, foreign charities are able to seek to being recognized as an ANBI according to Dutch tax law in a practical equivalency determination, thereby subjecting themselves to effective control by the Dutch tax authorities. The unwilling jurisdictions are not (yet) convinced that the international privileges of charitable flows of money can be accorded in a responsible way.

As has been demonstrated in my dissertation and summarized in several international publications[10], in my view it is (still) unthinkable and undesirable in a globalized world that international philanthropy will not be freed from landlocked tax barriers. A discriminatory treatment of philanthropy organizations relative to domestic comparable organizations contradicts the political philosophy of pluralism that explains the principled exemption of taxes of philanthropic organizations and flow of money. Exemption of taxation of philanthropic organizations is a principled element of Western democratic society and where the world is globalizing, the pluralistic forces become increasingly global as well.

What is required, however, is to address the issue of proper control in full. The Commission could direct and coordinate Member States to create an international norm of expenditure responsibility provisions, according to models that already exist in detail in US legislation. To the extent that control over cross border funding is manageable, tax authorities will be less reluctant to open their borders and more willing to expand their existing procedures for cross-border relief. If the emphasis is placed on these practical issues, the legal constraints of the equivalency tests (*when is a foreign organization exactly comparable to our domestic philanthropic organizations?)* will not (longer considered to) be as important and international philanthropy will be increasingly freed from tax barriers.

4. Policymakers versus non-profit sector: who plays the ball ?

In the last chapter of the DAFNE/EFC report, it focuses on the power of self-regulation by the non-profit sector. Rather than focusing on the European or national policy makers, the question has to be addressed why the non-profit sector itself would not undertake action.

Dr. Breens Report describes two examples of governances codes in Switzerland and Finland, that are not compulsory but due to the public expectation and peer pressure, courts are increasingly referring to the codes as well. However, the existence of a code does not mean that non-profit organizations are being monitored on their compliance let alone there are sanctions on non-compliance.

An unique exception is Ireland, where the Irish Charity Act provides for the possibility to approve existing self-regulatory codes, thereby giving regulatory 'imprimatur' to a voluntary code as developed by the sector[11].

There are many reasons why the non-profit sector should undertake action:

[10] E.g. Bucherius Law School, Non Profit Yearbook 2010.
[11] DAFNE/EFC Report 2018, p. 56.

a) The fact that the DAFNE/EFC report talks about the trend of closing space for European philanthropy should be an alarming signal. A common feature of a trend is that people of all sorts will be following, without exactly knowing what they are doing.

b) The supranational and national legislators will ultimately undertake legislative action in respect of exactly these issues that are relevant to international resolving of tax obstacles: effective control on the operational test of organizations, with effective expenditure responsibility provisions in place. A foreign philanthropy organization has to exercise expenditure philanthropy towards domestic tax authorities, if it has benefited (indirectly) from domestic tax relief. This may be backed up by provisions that make foreign organizations liable towards the domestic tax authorities; donors may have an intermediary role in this respect such as withholding tax that will only be released upon the foreign body providing satisfactory full reports on the expenditure of the contributed funds. [12]

   It would be prudent to act proactively in this respect and make proposals that are workable for the sector.

c) With the anti-democratic forces in our international society, there is the general risk to the overall integrity of the charitable sector and the willingness of governments to deal, in a benevolent manner, with bona fide charitable organizations. This should alert the sector and make it as proactive as can be.

d) One of the main issues of this debate, although not expressed as such, is the issue of cost. Appropriate control of international flows of philanthropic money is costly and it is unrealistic to expect that tax authorities or administrative authorities will fully undertake this control. If the non-profit sector does not voluntarily act on this, it is more likely that legislators will not resolve the international obstacles since it is simply too burdensome for the tax authorities to effectively control; rather, they should be expected to verify and evaluate the control undertaken by the philanthropic organization itself.

In conclusion, my main recommendation to DAFNE/ECF would be to really follow up on the quote used by Dr. Oonagh Breen and shown at the head of this commentary, by initiating a debate with the non-profit sector on modelling sound provisions on effective international control on philanthropy; that would really be something different !

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[12] See for a more extensive discussion, Koele, par. 7.3 Various scenarios for resolution of the landlock'.