International

Dr Ineke A. Koele*

How Will International Philanthropy Be Freed from Landlocked Tax Barriers?

This article examines the tax discrimination encountered by philanthropic organizations and donors in regard to international philanthropy and the developments in this regard within the European Union. The author concludes that in order to eliminate tax barriers to cross-border philanthropic flows responsibly and to protect the sector as a whole, it is vital to implement effective control over cross-border philanthropy.

1. Introduction

When governments falter as a result of financial crises or war, it is comforting to note that the world is not dependent on governments and supranational bodies alone, but that a silent but stable and influential role is played by the foundation sector.[1] Often philanthropic organizations are wealthy and have enormous influence over the development of modern society in areas such as research and development, social innovation, culture and art, health care, religion and development, education, etc. These organizations function without being directly influenced by politics, which increases the international effectiveness of their activities significantly.

A recent study[2] reveals that the EU foundation sector is a major economic force, consisting of an estimated 110,000 foundations (almost four foundations per 10,000 inhabitants) that spend between EUR 83 billion and EUR 150 billion each year, over twice as much as the US foundation sector, which consists of 71,000 foundations. Foundations also provide direct full-time employment to between 750,000 and one million people in Europe.

The world foundation sector and its stakeholders are becoming increasingly interconnected as a result of globalization. However, our legal perception of this area is outdated and needs to be addressed.

Even though non-discrimination has been a norm of international tax law for decades, it has not been consistently applied to philanthropic organizations. For example, a donation to the Louvre in Paris could be treated differently depending on the country of residence of the donor. A donation from a French resident would qualify for tax relief, whereas a donation from a US or UK resident would not. In practice, therefore, sophisticated structures have been designed by the larger philanthropic organizations to allow foreign residents to donate to domestic charities that in turn undertake to distribute these gifts (although at their absolute discretion) to, for example, the Louvre. These sophisticated structures are required because the legislation of nearly all countries that provide for some form of tax relief for philanthropic flows of money is, or at least was until recently, 'landlocked'. Landlocked elements of a legal or tax regime are characterized by a direct or indirect geographical limitation imposed as a condition for recognition or favourable tax treatment of philanthropic activities.

Generally speaking, elements of landlocked tax relief include the following:
– donations and bequests to foreign philanthropic organizations are not exempt from gift, inheritance or estate tax, whilst donations and bequests to domestic philanthropic organizations are eligible for such an exemption;
– donations to foreign philanthropic organizations do not entitle the donor to claim an income tax deduction whilst donations (and sometimes bequests) to domestic organizations are eligible for such a deduction;
– investments held by foreign philanthropic organizations are subject to tax whilst similar domestic organizations can benefit from an exemption; and
– stringent rules apply to international expenditures of philanthropic organizations, whilst domestic expenditures are not subject to this level of scrutiny.

There are also legal impediments. For example, a German foundation may face serious problems if it wants to raise funds in Ireland since, because it is not incorporated under Irish laws, it is not able to open a bank account in Ireland.

The Commission, in recent years, has received numerous complaints from foundations whose international efforts are being hindered by legal provisions in the laws of Member States that, in fact, discriminate against foundations established in other Member States in comparison to domestic organizations. As a result, such 'landlocked' provisions in the legislation of Member States have been put high on the Commission's agenda. The

* **Lawyer and Tax Adviser, Koele Private Clients and Charities. The author can be contacted at ineke@koelepc.com.**

1. The term 'foundation' is not used herein as a reference to a legal form, but rather as a functional reference to philanthropic organizations. This can be compared to the use of the term 'private foundation' under US tax law, although the legal form of a foundation does not exist under US law. The author uses the terms 'foundation' and 'philanthropic organization' interchangeably.
2. Feasibility Study on a European Foundation Statute, by Max Planck Institute for Comparative and International Private Law and the Centre of Social Investment of the University of Heidelberg, undertaken for the benefit of the European Commission, published on 16 February 2009, available at http://ec.europa.eu/internal_market/company/eufoundation/index_en.htm.

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European Court of Justice (ECJ) addressed this issue in two landmark decisions, i.e. *Walter Stauffer*[3] and *Persche*.[4] The case law of some Member States has held that landlocked provisions conflict with the provisions of the Treaty on the Functioning of the European Union (TFEU). Currently, a number of Member States are adopting legislation that opens the borders for international philanthropy and effectively resolves the issue of 'landlocking'. Some countries have also opened their borders beyond the European Union. However, some Member States are reluctant to do so and have introduced provisions to counteract this development.

This contribution will look at these developments in some detail and, based on the conclusions of an academic research project undertaken on the subject,[5] will provide concrete suggestions for a viable and responsible way of resolving the issue.

2. EU Developments

2.1. ECJ: two landmark decisions prohibit 'landlocking'

Within the European Union, EU law and ECJ case law have gained substantial influence over the domestic laws of the Member States in recent decades. This influence cannot be overestimated, as in all Member States EU law and, therefore, the decisions of the ECJ, overrule the application of domestic laws.

In regard to tax laws, the fundamental freedoms have been key in the development of the case law of the ECJ. The four fundamental freedoms are the free movement of goods, persons, services and capital as laid down in the TFEU. These specific provisions are designed to prohibit discrimination on the grounds of nationality, as enshrined in Art. 18 of the TFEU (previously, Art. 12 of the EC Treaty).

Although the starting point of the TFEU is that all Member States have fiscal sovereignty and, therefore, are free to determine the criteria for levying taxes, the case law of the ECJ has made it clear that Member States may not exercise this sovereignty in a manner that restricts or violates any of the freedoms of movement. Over the years, the ECJ has expanded the traditional scope of the concept of non-discrimination on grounds of nationality to include the notion of "restrictions or impediments to a national of a Member State to exercise any of the freedom of movements, even if these restrictions or impediments apply independent from the nationality of the persons in question".[6] According to this line of reasoning discrimination also exists where discriminatory criteria, other than nationality, in fact have the same result. Many situations in which the treatment of residents and non-residents differs result in a disadvantage for nationals of other Member States, as in most cases non-residents are foreigners.[7]

Consequently, the ECJ has consistently held that any disadvantageous unequal treatment of resident and non-resident taxpayers in comparable situations constitutes covert discrimination and is, therefore, in violation of EU law, unless the treatment is justified according to the "rule of reason".[8] In order to be compatible with the EU Treaty, the rule of reason requires that national provisions that are liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the TFEU must fulfil the following four conditions:

– they must be applied in a non-discriminatory manner;
– they must be justified by imperative requirements in the general interest;
– they must be suitable for securing the attainment of the objective that they pursue; and
– they must not go beyond what is necessary in order to attain such objective.[9]

The ECJ decision[10] in the *Walter Stauffer* case clearly set the scene by following the Opinion of Advocate General Stix-Hackl that Centro di Musicologia Walter Stauffer, an Italian philanthropic organization that owns and rents out German-situs real property, is objectively comparable to a domestic (i.e.German) philanthropic organization. The Court furthermore decided that no overriding requirements in the general interest were found that justified the unequal treatment of the Walter Stauffer organization. The most interesting justification that was asserted was the need to ensure the effectiveness of fiscal supervision. The ECJ noted that before granting a foundation a tax exemption, a Member State is permitted to apply measures to ascertain, in a clear and precise manner, whether or not the foundation meets the conditions imposed under domestic law in order to be entitled to the exemption and to monitor its effective management, for example, by requiring the submission of annual accounts and an activity report. Admittedly, where foundations are established in other Member States, it may be more difficult to carry out the necessary supervision. Nevertheless, the Court added, these are disadvantages of a purely administrative nature that are not sufficient to justify a refusal by the authorities of the relevant Member State to grant such foundations the same tax exemptions that are granted to foundations of the same nature, that, in principle, are subject to unlimited tax liability in that state.[11]

The ECJ goes on to say that there is nothing to prevent the relevant tax authorities from requiring a charitable foundation claiming a tax exemption to provide appro-

3. ECJ, 14 September 2006, Case C-386/04, *Centro di Musicologia Walter Stauffer v. FA München für Körperschaften* (*Walter Stauffer*).
4. ECJ, 27 January 2009, Case C-318/07, *Hein Persche v. Finanzamt Lüdenscheid (Persche)*.
5. Ineke A. Koele, *International Taxation of Philanthropy* (Amsterdam: IBFD, 2007) (doctoral dissertation, University of Utrecht, 2007).
6. ECJ, 15 December 1995, Case C-415/93, *Union royale belge des sociétés de football association ASBL v. Jean-Marc Bosman, Royal club liégeois SA v. Jean-Marc Bosman and others and Union des associations européennes de football (UEFA) v. Jean-Marc Bosman*.
7. See, for example, ECJ, 14 February 1995, Case C-279/93, *Finanzamt Köln-Altstadt v. Roland Schumacker*, Para. 28.
8. For example, *Schumacker*, id., Para. 37.
9. ECJ, 30 November 1995, Case C-55/94, *Reinhard Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano*,
10. *Walter Stauffer*, see note 3.
11. Id., at Para. 48.

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priate supporting evidence to enable those authorities to exercise the necessary controls.

In a second landmark decision of 27 January 2009, the ECJ went on to say that since the possibility of obtaining a deduction for tax purposes can have a significant influence on the donor's attitude, the inability in Germany to deduct gifts to charitable organizations that are established in other Member States, for example, Portugal is likely to affect the willingness of German taxpayers to make gifts for their benefit and consequently the discriminatory legislation constitutes a restriction on the free movement of capital.[12]

In the *Persche* case, the German, Spanish, Irish and UK governments pointed out that gifts to domestic bodies and gifts in favour of bodies established in other Member States are not comparable in the sense that the Member States concerned (1) may apply different concepts of benevolence, as well as different requirements for recognition of acts of benevolence; and (2) they are not in a position to monitor compliance with the requirements they impose other than in relation to national bodies. The German, Spanish and French governments added that if a Member State abstains from levying certain taxes by exempting gifts made for the benefit of charitable bodies established in that state, it is because such bodies absolve that Member State of certain charitable responsibilities that it would otherwise have to fulfil itself using tax revenues. This reasoning, which may be referred to as the 'expenditure theory', a political rationale for the deduction of gifts for tax purposes, has been rejected by the ECJ, in principle.[13]

It should be noted here, that a government does not have a monopoly on charitable activities, which demonstrates the flawed reasoning of the expenditure theory. Religious organizations are typical examples of organizations with public purposes that, by their very nature, cannot be performed by governments in western democratic societies. The explicit or implicit rationale for tax exemptions of philanthropic organizations is in all Western democratic countries found in the political philosophy of 'pluralism'. Western Democratic societies have plural 'public' powers, and government has not a monopoly on serving public interest purposes.

The ECJ went on to hold that even where tax authorities have to obtain the necessary information from a donor rather than from the body that received the gift, the same reasoning as applied in the *Walter Stauffer* decision would prevent a legislator from excluding, a priori, that a taxpayer is able to provide the relevant documentary evidence to enable the tax authorities to ascertain, clearly and precisely, the nature and genuineness of expenditure in other Member States. It is usually possible for a donor to obtain from the recipient charitable organization documents confirming the amount and nature of the gift made, identifying the objectives pursued by the body and certifying the propriety of the management of the gifts that were made to it.[14]

Finally, the ECJ provides some suggestions to domestic tax authorities on how they should view foreign charitable organizations in comparison to their domestic counterparts.

First, it suggests that declarations by a body that fulfils, in its Member State of establishment, the requirements of the legislation of that Member State for the granting of tax advantages, cannot be left out of consideration relating to domestic qualification, particularly if that legislation makes the granting of tax advantages intended to encourage charitable activities subject to identical requirements as in the domestic Member State.[15] The question, of course, is what 'identical requirements' are in this context.

Second, it suggests that if the foreign Member State of establishment of the recipient body has a system of tax advantages intended to support the activities of charitable bodies, it will normally be sufficient for the donor's Member State to be informed by the other Member State, within the framework of the Mutual Assistance Directive (77/799/EEC), of the subject matter and details regarding the supervision to which such bodies are subject, in order for the domestic tax authorities to be able to verify whether or not the recipient body fulfils the conditions imposed by domestic legislation for granting tax advantages.

In conclusion, it was held that the argument brought forward by Germany, Ireland and the United Kingdom, pursuant to which it is contrary to the principle of proportionality to constrain the donor's Member State in these circumstances to verify or to have verified compliance with conditions imposed on national charitable bodies for each gift made by a taxpayer to foreign similar bodies, must be rejected. This decision certainly represents an important step forward in the process of resolving the landlock in cross-border philanthropy within the European Union. However, it would be too optimistic to state that this ECJ decision alone has paved the way to a full resolution of landlocked tax regimes.

As Advocate General Mengozzi stated in his Opinion in the *Persche* case,[16] it is the premise of the German legislation that, *as a matter of principle*, charitable bodies with a foreign establishment are in a situation that is not objectively comparable to that of charitable bodies established in Germany, that infringes the freedom of capital. However, in the *Persche* case, the national court provided no information regarding whether or not the Portuguese recipient body complied with the conditions provided for in its statutes and with those imposed by the German

12. *Persche*, see note 4.
13. Id., at Para. 44: "Whilst it is lawful for a Member State to restrict the grant of tax advantages to bodies pursuing certain of its charitable purposes, a Member State cannot however restrict the benefit of such advantages only to bodies established in that State whose activities are thus capable of absolving it of some of its responsibilities."
14. Id., at Para. 57.
15. Id., at Para. 58.
16. ECJ, 14 October 2008, Advocate General Mengozzi's Opinion, Case C-318/07, *Hein Persche v. Finanzamt Lüdenscheid (Persche)*, Paras. 72 and 73.

legislation, which required that the organization actually be managed in accordance with the objects stated in its statutes. This lacuna is explained by the fact that the preliminary ruling only raised the question as to whether or not the *principled* exclusion of foreign charitable bodies contradicts the TFEU. The answer to this question is negative, however, this does not imply that the recipient foreign charity would indeed meet all the requirements of the German legislation that are imposed equally on domestic charitable organizations in order to be eligible for tax efficient donations from donors. In May 2009, the German Federal Tax Court[17] referred the *Persche* case back to the Tax Court of Münster to examine whether or not the Portuguese organization can be compared to a charitable organization resident in Germany. It depends entirely on how literally the German requirements will be interpreted since it is unlikely that the constitutional documents of a Portuguese charitable organization would literally meet all the requirements of German law on philanthropic organizations.

In both *Walter Stauffer* and *Persche*, the ECJ made it clear that it is not a requirement under EU law for Member States to automatically confer on foreign foundations recognized as having charitable status in their Member State of origin the same status in their own jurisdiction. Member States have discretion in this regard, but must exercise that discretion in accordance with EU law. In these circumstances, they are free to determine which interests of the general public they wish to promote by granting benefits to charitable organizations that pursue objectives linked to such interests in an unbiased manner.[18]

Another ECJ decision that is relevant to this issue is *Laboratoires Fournier SA*,[19] The French special tax credit for research, which only applies to research activities carried out in France, was held to be directly contrary to the objective of the EU policy on research and technological development which, according to Art. 179(1) of the TFEU (previously Art. 163(1) of the EC Treaty) is, inter alia, "strengthening the scientific and technological bases of Community industry and encouraging it to become more competitive at an international level". Art. 179(2) of the TFEU (previously, Art. 163(2) of the EC Treaty) provides, in particular, that, for this purpose, the European Union is to "support [undertakings'] efforts to cooperate with one another, aiming, notably, at […] enabling [them] to exploit the internal market potential to the full, in particular through […] the removal of legal and fiscal obstacles to that cooperation".

Since the significant amendments to the EC Treaty (now TFEU) by the Treaty of Maastricht in 1993, the scope of the EC Treaty has been expanded to support not only economic progress within the European Union, but also EU policies on many areas of public interest that fall within the scope of public purposes that are pursued by philanthropic organizations.[20] In fact, most public purposes applicable to a philanthropic organization that are limited to a Member State's territory or national public interest will be directly contrary to the objective of the EU policy in regard to these purposes. In this regard, not only should the fundamental freedom provisions be considered, but also the prohibition of State aid provided for in Art. 107 of the TFEU (previously, Art. 87 of the EC Treaty); a law that takes an isolationist and, therefore, strictly landlocked approach with regard to 'public purposes' is likely to be scrutinized by the Commission as possibly constituting prohibited State aid.[21]

2.2. Commission action: infringement procedures and tax coordination

The Commission takes an active approach 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. Currently, 19 infringement procedures are pending and at least 10 have been successfully closed as a result of Member States amending their legislation. The most recent announcement was on 20 November 2009, when the Commission published a reasoned opinion (the second stage of the infringement procedure under Art. 258 of the TFEU – previously, Art. 226 of the EC Treaty) requesting that France amend its tax regime for donations to public interest and not-for-profit bodies based in other Member States or EEA countries. Under the French regime, public bodies, public-interest bodies in France and not-for-profit bodies carrying out their activities in France are exempt from dividend tax and transfer duties on donations and bequests. In contrast, similar bodies based or active in other Member States or EEA countries were subject to transfer duties at a rate of 60% of the value of the donations or bequests received. In addition, the regime in question grants income tax relief for donations solely to domestic organizations.

The Commission has not yet reached the point of referring cases to the ECJ – the third step of an infringement procedure, which applies if the Member State does not respond to a reasoned opinion – but this is likely to happen in the future.

One of the first Commission infringement procedures was against the United Kingdom.[22] Upon the initiative of the United Kingdom, a forum has been initiated with the Commission and other Member States to reiterate the decision of the *Walter Stauffer* and *Persche* cases and to explore how cross-border tax relief can be combined with proper management of the risks regarding fraud

17. German Federal Tax Court, 27 May 2009, XR 46/05; BFH/NV 2009,1633.
18. *Walter Stauffer*, see note 3, Para. 39.
19. ECJ, 10 March 2005, Case C-39/04, *Laboratoires Fournier SA v. Direction des vérifications nationals et internationales*, Para. 23.
20. Arts. 165 -211 TFEU (previously, Arts. 149-181 EC Treaty) contain specific policy descriptions that are not of an economic nature, including regarding education, culture, public health, consumer protection, economic and social cohesion, research and technical development, the environment and development cooperation of developing countries.
21. Koele, see note 5, p. 338.
22. European Commission Press Release IP/06/964, 10 July 2006.

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and security under the heading of 'coordination' of procedures and requirements.[23]

2.3. Recent tax law reforms within the European Union that resolve landlocked elements of tax legislation

As a result of the Commission's activity, 12 Member States have resolved elements of their landlocked legislation referring to cross-border philanthropy: Poland, Slovenia, the Netherlands, Denmark, the Czech Republic, Luxembourg, Bulgaria, Latvia, Greece, Belgium, Germany and France.

Although this is not the place to discuss the details of all the Member States' amendments, some recent developments are interesting to highlight. As of 1 January 2008, the Netherlands has removed all landlocked elements of its legislation; it was the first country in the world to make gifts to foreign charities fully deductible for Dutch resident individual and corporate donors and provide for an equivalent exemption for gift and inheritance tax. Accordingly, corporate income tax is not levied if the profits are paid to a foreign philanthropic organization that qualifies for Dutch tax purposes.[24] A foreign philanthropic body must seek recognition in the Netherlands, which is an easy process (relative to the procedures that are in place in many other countries) that is based on a self-assessment by the foreign organization. At first, this liberal approach was formalized only for charities established in Member States or in countries with which the Netherlands has tax treaties in place with appropriate exchange of information clauses: an important country in this category is the United States. As of November 2008, however, it was announced that charitable bodies in any country could seek recognition as a qualifying charity for Dutch purposes. Presently, the Dutch Charity Team receives a few hundred requests for registration per week and predominantly relies on a self-assessment procedure; if the foreign charitable body declares itself to be compatible with a list of key requirements that are formulated in a functional manner,[25] it will automatically receive the desired tax status. If the tax authorities later find, however, that the organization has improperly assessed itself as compatible with the Dutch requirements for charitable organizations, the tax status can be withdrawn retroactively. It is not certain whether or not donors would be protected by such a retroactive withdrawal of the charitable tax status of a foreign organization.[26] In practice, therefore, foreign charities that wish to have certainty regarding their eligibility for tax relief in the Netherlands, will send a descriptive submission to the tax authorities on their factual activities and purposes that is relevant according to Dutch criteria in order to be able to rely on the recognition by the Dutch tax authorities in their specific situation. Although the self- assessment system is certainly very practical, the Dutch government does not seem, as a follow-up to the amendments, to have designed a diligent system of effective control over the cross-border flows of philanthropic money. Such control needs to be proportionate to the tax benefits obtained by the foreign charitable body and backed up by sufficient tax inspectors to verify conformity with such measures.

With effect from 2010, France has resolved the landlock and now grants equal income tax relief to individual and corporate donors for their gifts to foreign organizations established within the European Union or within the European Economic Area[27] that qualify as philanthropic organizations according to French requirements. In order to be able to benefit from tax relief, there are two procedures available: (1) the foreign organization enters into an agreement with the French tax administration on its qualification and the conditions to be maintained, or (2) the donor may benefit from the tax advantages if the donor is able to provide evidence of the fact that the foreign organization that is the recipient of a gift is comparable to French exempt organizations. Details of this *onus of proof* will be refined in a decree.

Belgium has equally resolved the landlocked income tax deduction for gifts to qualifying philanthropic organizations within the European Union and the European Economic Area with effect from 2010. In Belgium, the applicable procedure is that the donor must provide documents to the Belgian tax authorities showing that the foreign organization has been recognized as a philanthropic organization in its country of residence and that the organization is comparable to a Belgian qualifying philanthropic organization.

On 18 March 2010, the Commission formally requested[28] that the Netherlands change its rules concerning tax incentives for local taxpayers making donations to foreign-based public benefit organizations; the aspect of the provisions that triggered this reaction of the Commission is the compulsory registration procedure of foreign philanthropic organizations. The Commission considers these requirements to be unnecessarily restrictive, since they do not allow for the possibility of tax relief in cases where the foreign receiving organization has not registered itself as charitable in the Netherlands. The Dutch rules do not give the taxpayer the possibility to prove that a donation to a foreign pub-

23. According to the Open Method of Coordination, which has been a policy instrument of the European Union since the Lisbon Strategy that was adopted at the conference of the European Council in Lisbon in 2000, which proposed that the European Union become the most dynamic knowledge economy of the world within ten years.

24. Provided the other requirements for effective exemption of corporate income tax are met; the effective exemption takes the form of a deduction of dividends distributed to the qualifying philanthropic organization, Art. 9(1)(h) of the Corporate Income Tax Act.

25. For example, rather than stipulating that a certain percentage of funds must be expended within a certain timeframe, the organization has to declare that it does not maintain more properties than are reasonably required for the continuity of the activities according to the public interest purpose of the organization. In addition to this list of questions, a management policy has to be in place in which explanations to these issues have to be included.

26. Although the State Secretary has announced that donors in good faith have to be protected, there is no basis for this in the law: Parliamentary History, law proposal 31930, Tweede Kamer, No. 8, pp. 2-3.

27. Exemption is only available for organizations resident in countries within the ER that have concluded a bilateral treaty with France containing a clause for assistance regarding tax fraud or evasion.

28. In the form of a reasoned opinion, the second step of an infringement procedure provided for by Art. 258 of the TFEU.

lic benefit organization satisfies the Dutch requirements for tax incentives. Consequently, the rules are considered to be contrary to the freedom of movement of capital. In the author's opinion, this seems to be a flawed initiative of the Commission, since there is no discriminatory treatment between foreign and domestic charities in this regard under Dutch tax laws. All charities, whether based in the Netherlands, the European Union or any other country, have to be recognized before they are considered to be eligible for tax relief. The European non-discrimination principles do not require Member States to refrain from enacting control provisions whether in the form of registration or otherwise but they have to ensure that any controlling mechanism in place is maintained in accordance with the non-discrimination provisions provided for by the TFEU.

The UK announced in the Finance Act 2010 issued in March 2010 a new definition for organizations eligible for charitable tax reliefs that will include those based in the European Union, Norway or Iceland under certain conditions. This relief may be available retroactively to 27 January 2009, the date of the *Persche* judgment of the ECJ, on a case-by-case basis. The tradition in the United Kingdom is that all domestic (and foreign) charities have to be registered as such, in order to obtain tax relief. According to the rules set out in the Finance Act 2010, a, for example, Dutch charitable foundation may be recognized as eligible for UK tax relief if (1) it meets the England and Wales definition of a charity, (2) is regulated by a body in the Netherlands that has an equivalent function to the Charity Commission or a similar regulator, as required by Dutch laws and (3) is managed by 'fit and proper persons'.

The key question will ultimately be what level of control will be considered normative in this respect, since the control exercised by the Charity Commission cannot be compared in practical terms with the level of control exercised by the tax authorities in the Netherlands and in many other Member States where no Charity Commission or equivalent exists.

It will, therefore, be interesting to learn how the UK Inland Revenue will interpret these rules once they are enacted. However, the UK probably has the same problem with the Commission as the Netherlands since it requires a preliminary registration of all foreign charities.

Hungary, in contrast, has abolished tax incentives for philanthropy entirely and, therefore, is no longer in breach of the TFEU. Another negative reaction was initiated by the German tax authorities as a result of the *Walter Stauffer* case. The ECJ decided in *Walter Stauffer* that EU law does not require Member States to automatically confer on foreign foundations recognized as having charitable status in their Member State of origin the same status as in their own territory. In this context the German legislator did resolve the landlock but at the same time, amended the general requirement for philanthropic organizations. Art. 51(2) of the Fiscal Code (*Abgabenordnung*) provides for the general requirement that an organization (whether resident in Germany or elsewhere) carrying out the promotion of tax-privileged purposes abroad shall either further individuals resident or domiciled in Germany or shall – among other things – make a possible contribution to the reputation of the Federal Republic of Germany abroad. It is unclear how the German tax authorities will apply this requirement in practice. In the author's opinion, it would be unlikely that a philanthropic organization would be viewed as not contributing to the reputation of the Federal Republic of Germany since Germany is, like all of us, part of a globalized world. Any purpose that serves the pluralism of German society, in its broadest sense would have a positive impact on that society.[29] It is likely, however, that the German legislator has a more defensive strategy in mind with these new provisions.

2.4. European Foundation Statute and feasibility study

On 16 February 2009, the Commission published a Feasibility Study on the European Foundation Statute.[30] The report calculates the cost of barriers to cross-border activities of European foundations. The cost is estimated to be between EUR 90,000,000 and EUR 101,700,000 per year. There are also other incalculable costs. The growing potential for cross-border philanthropy in Europe suggests that these figures represent minimum amounts that are likely to grow in the future.

The study suggests that the European Foundation Statute is the preferable policy option to address cross-border barriers. The European Foundation would be an additional and optional instrument like the existing European Company (*Societas Europaea*), the European Economic Interest Grouping, the European Cooperative Society (*Societas Cooperativa Europaea*)and, most recently, the proposed European Private Company (*Societas Privata Europaea*).

The European Foundation Statute is designed mainly to overcome existing legal barriers. In addition, the study describes the option of establishing a European Foundation with tax-exempt status in all Member States. It is acknowledged by the report that harmonization or a compulsory treaty on the tax status between Member States would not be realistic as there is no consensus between Member States on this issue. The Report alternatively suggests that the European Foundation combine all requirements of the tax laws of the Member States (de facto lowest common denominator), i.e. by allowing only such public benefit purposes as are allowed in all Member States, by prohibiting remuneration for boards of directors (as under Spanish tax law), by imposing a duty of timely disbursement and several formal statements in the foundation's statute (as under German tax law), by allowing only purposes that are regarded as for the 'public benefit' in every Member State, etc.[31] The consequence of this would be that the European Foundation

29. See, for a more extensive discussion, Koele, note 5, p. 196 et seq.
30. Feasibility Study, see note 2.
31. Feasibility Study, note 2, p. 192 et seq.

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would be recognized as qualifying as a philanthropic organization in all Member States. The report adds that, at first sight, such a tax-exempt European Foundation may seem unrealistic because it would be over-regulated and too 'bureaucratic'. However, the study also revealed that the tax law similarities between the Member States seem to be greater than foundation law similarities and, therefore, such a European Foundation that would qualify for a tax exemption in all Member States could be a viable option that is worth considering.[32]

The Feasibility Study refers exclusively to equivalency of legal requirements and presupposes that under a theoretical model where all existing (functional) requirements in all Member States are met, the automatic consequence would be recognition of such a European Foundation irrespective of the actual location of its establishment and activities. However, the report does not substantiate the logic of this consequence. What is missing, is an effective tool to control a foreign-based philanthropic organization (whether a European Foundation or an existing legal form of philanthropic organization), regardless of the requirements to which such an organization is subjected.[33]

3. The Missing Link: Control over International Philanthropy

3.1. In general

In all the discussions on resolving the problem of landlocked provisions and discrimination against foreign-based philanthropic organizations, little attention has been paid to the legitimate concern of states to effectively control cross-border philanthropic flows of money. In a comparative study of the United States, Germany and the Netherlands, the author's conclusion was that the only rationale for the existence of landlocked provisions in tax laws relating to cross-border philanthropic transfers is the fact that supervisory authorities do not exert sufficient control over the international flow of grant making. No conceptual arguments were found to support or explain the existence of landlocked tax provisions; the landlocking is not based on conceptual differences regarding the notion of and the functioning of philanthropic organizations.

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. In times of budgetary stringency the risk increases that states will react negatively to pressure by the Commission, with the likely result that incentives for philanthropic organizations will be reduced or eliminated and the criteria will be tightened, as has been illustrated by the situation in Hungary and Germany.

The recent UK, French and Belgian versions of the resolution of the landlock are based on a tax relief to be granted on a case-by-case basis where sufficient evidence has been provided by the donor (in the case of Belgium), by the donor or the charity (in the case of France), or by the charitable organization (as in the UK proposal).

In the Netherlands, the tax authorities require a foreign organization like a domestic organization to seek recognition as a qualifying public interest organization. Although foreign charities are being recognized on a case-by-case basis, in practice, foreign and domestic organizations may choose whether to be controlled in advance (in which situation the confirmation may be binding on the tax authorities if some conditions are met) or may seek recognition through a self-assessment procedure in which case *formal recognition* is obtained that may later be withdrawn by the tax authorities after being controlled.

From all these examples it follows that control is paramount in the practice of resolving the tax impediments to cross-border philanthropy.

Consequently, and based on the author's PhD research findings, a responsible and viable resolution of landlocked tax provisions would include measures that:

- provide for specific requirements for tax privileges in an international context, which are referred to as *equivalency considerations*; and
- govern the effective control that may be exercised with regard to expenditure of the funds abroad in accordance with qualifying public purposes, which are referred to as *expenditure responsibilities.*[34]

3.2. Equivalency considerations

It is unrealistic to expect states to automatically recognize the tax-privileged status of a philanthropic organization established under a foreign statutory law (recognition of the *lex fori* principle) as to do so would overrule the state's tax sovereignty over a matter that has not been the subject of legal harmonization between Member States. However, it is possible for states to specify the requirements that must be met by a foreign organization in order to be regarded as *equivalent* to a domestic qualifying philanthropic organization. It appears from the research conducted that in the tax legislation of the United States and Germany it is, in many instances, entirely unclear what is required in order for a foreign philanthropic organization to be considered equivalent to a domestic qualifying organization. No consistent approach is found in this field.

The more detailed a domestic tax law is, the more likely it is that foreign philanthropic organizations will not comply with the rules. Countries such as the United States and Germany recognize, in practice, that not all of their

32. Feasibility Study, note 2, p. 194.
33. See, for a critical view on the feasibility of the European Foundation in general, but specifically in relation to tax since the ability to tax is seen as a sacrosanct power of a sovereign nation, Dr. Oonagh Breen, "EU Regulation of Charitable Organizations: The Politics of Legally Enabling Civil Society", *The International Journal of Not-for-Profit Law*, Volume 10, Issue 3, June 2008.
34. Koele, note 5, Para. 7.2. "Key Elements for a resolution of the landlock", p. 358 et seq.

detailed regulatory requirements must be adhered to by foreign philanthropic organizations that are under the jurisdiction of another legal system; instead they conduct, in practice, a limited review. It would not serve a rational purpose to require foreign philanthropic organizations to meet all domestic rules; under such an expansive approach, the landlocking would remain. This expansive approach would undermine the interests of international philanthropy, as, in practice, it is scarcely possible for a philanthropic organization to meet simultaneously the requirements of all applicable regulatory provisions of both the United States and Germany.

In order to be able to apply a sensible equivalency test to a foreign philanthropic organization (vis-à-vis a domestic qualifying organization), countries should first determine which requirements are crucial in an international context and which requirements are 'couleur locale' and do not need to be maintained in an international context.

An important element of resolving landlocking, therefore, is the development by states of *normative equivalency tests* for international philanthropic purposes. In order to do so, countries should be willing to consider what requirements under foreign legal systems have a *similar function* to domestic requirements, even if the wording of these requirements is very different.

As a result of the author's research on the functionality of various domestic legal requirements, it was determined that, although the superficial features of the various legal systems differ to a large extent, the functionality of most of the requirements and features is more similar than different.[35] The best way of addressing normative equivalency tests is to provide for flexible and qualitative criteria that will be inclusive of various national legislations with similar functionalities. This would require legislatures and the people working with these rules to be able to take some distance of their own domestic legal system on international philanthropy in order to be able to direct an analytical eye back onto it. This is a logical consequence of globalization.

The equivalency test is not, however, as important as provisions that adequately provide for effective expenditure control in a cross-border context. The key question here is: if it is guaranteed that a payment is expended for a genuine and qualifying public interest purpose, would it matter if the recipient abroad was not equivalent to a domestic qualifying organization? In the legislation of both the United States and Germany, this answer is frequently negative. This means that ultimately, the question of equivalency is subordinate to the question of how expenditure responsibility should be regulated in a cross-border context.

3.3. Expenditure responsibility considerations

In order to address the concern of states regarding the exercise of effective control over the expenditure of philanthropic funds abroad, a detailed *expenditure responsibility* test for cross-border philanthropy has been identified as a key element.[36] As social investment becomes increasingly used instead of mere distributions or grants, the challenge will be to follow the trail of investments and their ongoing benefit for the public interest even more carefully.

Inspiration may be gleaned from the provisions that exist in both the United States and Germany for domestic charities that distribute their funds to foreign entities. The domestic bodies are responsible to prove to the tax authorities that the destination and use of the funds is in accordance with the domestic provisions. An important source of knowledge in this regard is the detailed US rules on expenditure responsibility that are specifically provided for private foundations, but are used increasingly, in practice, by US public charities as well.

In the United States, expenditure responsibility is defined as the responsibility:
- to exert all reasonable efforts and to establish adequate procedures to ensure that the gift is spent solely for the purpose for which it is made; this may, for example, imply the existence of a proper gift agreement that specifies the destination of the gift;
- to obtain full and complete reports from the recipient on how the funds are spent; and
- to make full and detailed reports with regard to such expenditures to the tax authorities.

In a cross-border context, a foreign philanthropic organization has to exercise expenditure responsibility towards domestic tax authorities. This may be backed up by provisions that make foreign organizations liable for the tax benefits granted or even provisions that oblige donors to withhold a percentage of the funds for the benefit of the tax authorities that will not be released until the foreign body provides satisfactory full reports on the expenditure of the contributed funds for the benefit of the domestic tax authorities.[37]

In countries where landlocking is still prevalent, donors may make use of 'facilitators'. In Europe, the Transnational Giving Network, introduced by the King Baudoin Foundation in Belgium, illustrates this concept. The donor transfers the funds to the local body that is within the Network that acts as a facilitator for the international transfer of the funds. The funds are received by the foreign body within the Network that ultimately disperses the funds to the intended recipient philanthropic organization. Although this is an effective means to overcome existing landlocked tax provisions in practice, these practical facilitators are not a true solution to the problems inherent to international philanthropy. Where no specific due diligence requirements exist regarding international philanthropy, this is manageable; but where due diligence and expenditure responsibilities become increasingly complex, it is likely to become

35. The same conclusion is found in the Feasibility Study, note 2, pp. 48-156.
36. Koele, note 5, Para. 7.2.2., p. 367 et seq.
37. See, for a more extensive discussion on this, Koele, note 5, Para. 7.3. "Various scenarios for resolution of the landlock".

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apparent that facilitators are not a feasible solution. Grant risk management ultimately cannot be delegated to a service provider that takes title to the funds.

Furthermore, also under the non-discrimination principle of the TFEU, foreign philanthropic organizations may have an increased burden of proof regarding control provisions, as it is difficult for tax authorities to effectively oversee the operations of a foreign body.

3.4. Alignment with other paradigms: the threat of anti-terrorism financing measures

The philanthropic sector finds itself increasingly faced with a new regulatory era, the paradigm of which is modelled on the fight against money laundering and terrorism financing. It is apparent in examining governmental and intergovernmental initiatives that due diligence procedures in the context of international philanthropy are central to this new paradigm. 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 back in 2002. These included the recommendation that countries review the adequacy of laws and regulations that relate to non-profit entities since these are particularly vulnerable to the financing of terrorism.[38] In this context, the FATF suggested that countries take steps to promote effective supervision and monitoring of their non-profit sector. Countries should have measures in place requiring that non-profit organizations (NPOs), inter alia:
- 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;
- know their beneficiaries and associate bodies. This means that an organization must use its best efforts to confirm the identity, credentials and good standing of its beneficiaries and associate NPOs. An NPO must also use its best efforts to document the identity of its significant donors and to respect donor confidentiality; and
- 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.

A similar set of recommendations was formulated by the European Union in 2005 as a Code of Conduct in the communication, "The prevention and fight against terrorist financing through enhanced national-level coordination and greater transparency of the non-profit sector".[39]

Furthermore, the FATF suggested in its 2002 publication "International Best Practices" on the subject of combating the abuse of non-profit organizations[40] that in jurisdictions that provide tax benefits to charities, tax authorities have a high level of interaction with the charitable community. This expertise is of special importance to the fight against terrorist financing, since it tends to focus on the financial workings of charities. Therefore, tax authorities should be encouraged to share information in the fight against terrorism.

On 24 February 2009, the OECD released a "Report on Abuse of Charities for Money-laundering and Tax Evasion",[41] which contains information provided by 19 countries and identifies a set of good practices that tax authorities vulnerable to the risk of this abuse might consider. The executive summary states that tax evasion and tax fraud through the abuse of charities is a serious and increasing risk in many countries although its impact is variable. Some countries estimate that the abuse of charities costs their treasury many hundreds of millions of dollars and is becoming more prevalent. As main recommendations, the OECD states that more emphasis has to be put on mechanisms to facilitate the exchange of information in general and between tax authorities, law enforcement agencies and others, and on good practices on an ongoing basis.

What is only mentioned in the context of this report, is the 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 new paradigm will inevitably lead to more stringent control over the activities of philanthropic organizations and governments may no longer be able to leave the philanthropic sector to self-governance. In regard to the integrity of the philanthropic sector in general and a globalizing philanthropic ambition, however, this new paradigm will create an impetus for change since it will support the international recognition of effective control to be exercised by and in cooperation with other tax authorities.

4. Conclusions

It is unthinkable and undesirable that international philanthropy will not be freed from landlocked tax barriers. Cross-border philanthropy is part of our globalized world and will become increasingly important in the years to come. A discriminatory treatment of foreign philanthropic organizations relative to domestic comparable organizations is outdated and contradicts the political philosophy of pluralism that explains the principled exemption of taxes of philanthropic organizations and flows of money. Exemption of taxation is a principled element of Western democratic society and where the world is globalizing, the pluralistic forces become increasingly

38. FATF Special Recommendation VIII, available at http://www.fatf-gafi.org.
39. COM (2005) 620 final, available at http://europa.eu/legislation_summaries/justice_freedom_security/fight_against_terrorism/l33253_en.htm.
40. See http://www.fatf-gafi.org/dataoecd/53/53/34260889.pdf.
41. See http://www.oecd.org/dataoecd/30/20/42232037.pdf.

global as well. The question is, therefore, only: how will international philanthropy be freed from tax barriers, with what speed, and what will the consequences be?

The developments of the Commission and the ECJ support the unlocking of landlocked tax provisions, at least within the European Union. As a consequence of this development, a number of Member States have opened their borders to foreign charities. Others are considering following this initiative. At the level of control, however, the Commission is not clear in its wording and it is at this moment unclear how states will effectively be monitoring international philanthropic flows of money that benefit from domestic tax exemptions. Tax administration and courts will have to address issues of 'comparability' between foreign charitable jurisdictions and domestic jurisdictions or may adopt alternative procedures to handle these cases.[42] The Commission denies the desire of Member States to require a foreign organization to seek recognition as a philanthropic organization thereby imposing control over the organization. The relationship between a fundraising philanthropic organization and a donor is, in general, not suitable for the imposition of control via the donor. This may only be different in the situation of private foundations, where the donor has a dominant influence over the philanthropic organization as a founder or a major transferor. Accordingly, the desire of a state that the recipient organization submit to the controlling forces of a tax administration is generally legitimate provided it is practised in accordance with EU law. It is important that the Commission is considerate of the desire of states to exert control over the operations of foreign beneficient organizations that receive indirect tax relief. The comparability of foreign organizations and domestic organizations is an abstract question that needs a functional interpretation in order to be relevant for international comparability purposes. Ultimately, the issue that has to be addressed in order to release the landlock in a responsible manner is the issue of proper control. There is a fear, however, that opening borders to cross-border tax-efficient philanthropy, without proper control, may ultimately damage the entire sector.

The foundation sector itself may initiate a practice of appropriate controlling measures for international funding. There are other reasons, such as the paradigm of anti-terrorism financing practices, why the sector needs to concentrate on this area as well. The Commission could direct and coordinate Member States to create an international norm of expenditure responsibility provisions. 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 will not be as important and international philanthropy will be increasingly freed from tax barriers.

However, there will always be costs to the international foundation sector and these costs are likely to increase in an era where international philanthropy is becoming increasingly important and more complex. Appropriate control is costly and it is unrealistic to expect that tax authorities or administrative authorities will undertake this control; they may merely be expected to verify and evaluate the control undertaken by the organization itself.

42. For the purpose of some bilateral agreements, the practice already exists of considering the comparability of foreign organization and domestic organization; see, for example, Art. 36 of the Netherlands–United States tax treaty. In the US practice, the tax authorities rely on a combined opinion of a US and Dutch attorney as a reliable source of information.

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