

Where to locate an international charity?

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Charity begins at home, a well known proverb says. But where wealthy philanthropists have different homes around the globe and their capital, their lives and their public interests are no longer self-evidently bound to one jurisdiction, the search for an optimal location to establish an international operating charity on the globe becomes an appropriate exercise. Charity has been the subject of globalisation in recent years. New wealth created in the world is no longer automatically transferred to future generations within the family as negative effects of 'affluence' have become widely known. In larger family enterprises, a philanthropic organisation serves as the educator and catalyst of the 'values' of the family enterprise. The economical developments in the world during the last three years have made wealthy families more aware of the insecure value of 'inactive' money. In addition, the recent severe reduction of treasury budgets has made philanthropists in countries with a traditional strong and active public sector aware of their responsibility towards society. If tax systems equally provide for a full deduction of gifts against the highest income tax rates which exceed 50%, the choice for active *inter vivos* philanthropy becomes within the practical reach of many wealthy families.

Wealthy international philanthropists originating from countries where charities do not have a very favourable legal and tax climate are increasingly looking for a flexible jurisdiction to establish their international charity. Genuine philanthropic activities should only be located in jurisdictions whose integrity and reputation are without any doubt.

Important location factors

In order to select a location for an international operating charity that is endowed by a wealthy philanthropist, the first relevant issue is to avoid a location where a strong regulatory oversight exists over the precise activities of the charity. The existence of a Charity Commission in the UK and the very detailed regulatory oversight exercised by the IRS, backed up by excise taxes by way of penalties in cases of non-compliance in the US lead to the conclusion that the UK and the US are expensive and time-consuming locations for establishing international charities.

The conceptual difference between common law jurisdictions and (at least some of) the civil law jurisdictions is that in the latter, charitable organisations are principally considered as part of the private domain. Nonetheless, in many civil law countries in Europe, the state has strong regulatory powers over charities due to a historical aversion against (especially religious) charities that in the past were considered a threat to the state. Strong examples of this are France and Belgium.

Equally important is the protection that the jurisdiction may offer against foreign taxes on investment income and accordingly, an extensive bilateral treaty network that applies to charitable organisations (even if it is effectively exempt from taxation in the domestic treaty party) is a practically important location factor.

Where an international charity is located in an onshore, high taxation jurisdiction, it is of utmost importance that there is a favourable tax regime that applies to charities and that the requirements to become and remain recognised as a charity for tax purposes is not burdensome. Generally, the tax

status of a charity is required to obtain income tax exemptions on investment income and eventually on the receipt of gifts (eg in Switzerland), to obtain exemption of (high) gift taxation on the distribution of gifts or grants by the charity in accordance with its charitable purposes. There are jurisdictions with very specific and extensive requirements on what charities are and are not allowed to do and on the contrary, there are jurisdictions where charities have to meet open, more qualitative requirements that are meant to encompass all kind of different situations. In some countries, corporate entities that are held by charities do benefit from income tax exemptions (eg the UK, the Netherlands). In others, the charitable status does not imply a full exemption of income taxation on investment income or all types of business income (in the US and UK, non-related business income is not exempt from income tax).

Where wealthy families have wealth structured in offshore regimes, it may be possible to transfer funds to an onshore charity and thereby avoid effective taxation on these funds in the country of residence.

Where the donor is resident in a European civil law country that has adopted the exemption method as the means to avoid double taxation, it may be worthwhile to explore the possibility of an effective income tax deduction with respect to a cross-border European gift originating from privately held funds. Recent European developments backed up by European Court of Justice decisions on *Walter Stauffer* (2006) and *Persche* (2009) have resulted in the increasing recognition of European charities for tax purposes at least within Europe.

Further, it has to be envisaged that the ideal location for an international charity should not maintain practical restrictions or impediments on international grant making. The level of practical control by the tax authorities on the output of charities is often overlooked as a relevant factor for location of a charity, but the distinctions in this regard are substantial. Where, for example, Germany does not allow charities to transfer funds to other charitable organisations, but on the contrary requires organisations to pursue directly their charitable purpose in general, this may form a huge practical restriction. The US system has adopted very onerous tracing obligations for foreign charitable organisations that received a grant from a US private charitable foundation, with penalties for the US foundation in cases of non-compliance.

Furthermore, specific distinctions do apply. For example, political or campaigning purposes (eg as done by Greenpeace) may not qualify as charitable in many jurisdictions, but in the Netherlands, for example, there is no such restriction in the ambit of public purposes. In many countries, there is a restricted list of qualifying public purposes, whereas in other more liberal regimes all purposes that are in the public interest may qualify.

And ultimately, it is very important to focus on the default position of an organisation that would lose its favourable tax status due to a change in the law or the interpretation thereof. Where in a default position effective taxation on the income of a charity and the gifts performed by a charity may not be avoided, it is crucial that an effective exit is embedded in the structure without adverse tax consequences. This may, in practice, be difficult in some jurisdictions where the irrevocable endowment to a charitable organisation is considered a crucial element of the charity (for example in Switzerland, Germany).

The Netherlands charitable foundation as a flexible and liberal onshore location

In the Netherlands, philanthropic foundations are historically viewed as being part of the private domain rather than of the public domain. This explains why a strong regulatory oversight mechanism is lacking. There are only a few compulsory provisions that apply to foundations in general and there is no compulsory publication of annual accounts.

The Netherlands has a very extensive bilateral tax treaty network and has recently confirmed its international tax treaty policy to consider an exempt charitable foundation as a resident that may benefit from the advantages of a bilateral treaty in order to avoid 'virtual' double taxation.

The tax regime for charities is based on qualitative requirements that are not limited to restricted lists of public purposes but are flexible and liberal in nature. Due to the open norms that an international charity has to meet, in practice the charity confirmation is agreed upon in advance between the charity and the tax administration in order to secure the tax position of the charity before it enters the Dutch tax territory.

It is, however, important to note that the default position of a Dutch charitable foundation in case of loss of charity status does not mean that the organisation will become subject to

income tax on gifts or investment income; however, business income will become subject to income taxation. In addition, where the loss of charitable status would be influenced by the fact that the charity would in effect more than incidentally be directed to the private interests of the family of the philanthropist, it may well be argued that the Dutch resident charity would not be subject to gift tax on any distributions by the charity since it would be considered transparent for tax reasons. In addition, it is perfectly possible for a donor to include a revocability clause in the endowment that is contingent on the continuity of the tax regime on charities (an exit).

In addition, donations to Dutch charitable foundations may be offset against any Dutch taxable income even if the donor is not a resident of the Netherlands (extra-territorial income tax deduction) if structured adequately.

The Dutch flexible charitable foundation has long been sought after by large NGOs with complex governance structures, to create an effective establishment in the Netherlands or alternatively, to use it as a 'supranational' body since Dutch corporate law remains in effect even if there is no effective place of management in the Netherlands.

Increasingly, a Dutch charitable foundation is chosen as a flexible vehicle by the private philanthropist who is looking for a liberal, reputable and flexible jurisdiction that refrains from imposing stringent restrictions on governance, investments and expenditures.

There will be new challenges ahead that influence the location factors for international charities such as how tax administrations over the world will deal in practice with the increased efforts of charitable organisations to engage in the business sector in order to increase their impact. The era of philanthrocapitalism has just started and will trigger new discussions, regulations, limitations and opportunities. In the Netherlands, the political debate just started on how to balance the need for charities to engage in the market place (due to restrictions of state subsidies) and the maintenance of 'fair competition' with the business sector that is subject to full taxation.