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Tax Deductions for Charitable Gifts

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Income Tax Deduction for Contributions to US Charities Only

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The United States has generous tax concessions for philanthropy. Deductions for charitable contributions are available to US citizens, resident aliens and non-resident aliens when calculating income, gift and estate taxes. A charitable deduction is also available for corporate taxpayers. However, the rules are complicated and differ for each of the taxes and for different types of taxpayer. Advisers to US and multinational families interested in cross-border philanthropy must be especially mindful of when gifts to non-US charities qualify for such deductions.

Income Tax Deduction for Contributions to US Charities Only

A US citizen and any non-citizen resident in the United States for income tax purposes will be subject to US income tax on his or her worldwide income net of allowable deductions and exemptions. A non-resident alien is generally subject to US income tax only on US source income, with special exemptions for certain types of US source income such as portfolio interest and capital gains other than gains from the disposition of US real property (for further details please see the Overview (March 2006)). In calculating taxable income, US citizen, resident and non-resident taxpayers may be entitled to deduct charitable contributions, but only for contributions made to US charities, where no special treaty is applicable.

An income tax deduction is available only for contributions made to charitable organizations that are qualified as such by the Internal Revenue Service (IRS). Qualified charitable organizations include corporations, trusts, community chests, funds or foundations; but regardless of type of entity, they must be created or organized under the laws of the United States, any state, the District of Columbia or a US possession (with treaty exceptions for some Canadian, Mexican and Israeli charities). Domestic fraternal societies, orders or associations operating under the lodge system may also qualify. Qualified charitable organizations must be organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, or for the prevention of cruelty to children or animals. Certain organizations that foster national or international amateur sports competition may also qualify. To be certain of the status of a particular charitable organization, the taxpayer may ask the organization or check IRS Publication 78, "Cumulative List of Organizations", available at <http://apps.irs.gov/app/pub78>.

'Friends of' domestic charities and US charities with foreign activities

A taxpayer may be able to benefit a foreign organization and still obtain a charitable contribution deduction for US income tax purposes by giving to a 'friends of' domestic organization formed to support a foreign charity or charities. Alternatively, some US public charities operate abroad through a foreign branch office or subsidiary. An income tax deduction will be permitted for donations to such an organization as long as the foreign branch or subsidiary is under the complete control of the US charity so that it is the US organization which uses the funds in the foreign country, as opposed to such funds being used by a foreign organization. Certain US private foundations that comply with strict IRS regulations can make grants to foreign charities and provide another option for cross-border philanthropy qualifying for a US income tax deduction.

Limits on income tax charitable deductions

Taxpayers can generally deduct cash contributions as well as the fair market value of donated property. However, the amount of the income tax deduction is subject to certain limits. If the contribution entitles the donor to merchandise, goods or services, including admission to a charity ball, banquet, theatrical performance or sporting event, the taxpayer may deduct

only the amount that exceeds the fair market value of the benefit received. For a contribution of \$250 or more, the taxpayer can claim a deduction only if he or she obtains a written receipt from the qualified organization.

In addition, the annual income tax deduction for contributions made to public charities is generally limited to 50% of the taxpayer's adjusted gross income. The deduction for contributions to private charitable foundations is limited to 30% of the taxpayer's adjusted gross income. Contributions of appreciated property are further limited. Contributions in excess of the deduction limit may be carried forward for five years. The carryover is calculated with current charitable deductions according to the same limitations. This is a very simplified description of the charitable deduction limits for income tax purposes. For further details family advisers should review IRS Publication 526, "Charitable Contributions," which can be found at www.irs.gov.

Corporate Income Tax Deduction

Corporations subject to US income tax may also be entitled to a deduction for charitable contributions. However, in the corporate tax context a distinction is made for corporate contributions to charitable corporations and those made to a trust, community chest, fund or foundation. The income tax deduction is available in the case of a contribution to such a non-corporate entity only if it is to be used for charitable purposes within the United States or any of its possessions.

Gift Tax Deduction for Contributions to US and Certain Foreign Charities

Transfers of property - whether real property, tangibles or intangibles, and wherever located - by US citizens and residents are subject to US gift tax. Only gifts of real property and tangible personal property located in the United States are subject to the US gift tax when transferred by a non-resident alien (for further details please see the Overview (March 2006)). In computing taxable gifts a deduction is allowed to US citizen, resident and non-resident taxpayers for gifts to charity, but not always for gifts to non-US charities. The amount of the gift tax charitable deduction is unlimited, unlike the income tax charitable deduction, where annual percentage limits apply.

For citizen and resident donors, gifts to foreign charities may be deductible provided the charity is organized for religious, charitable, scientific, literary or educational purposes, including the encouragement of art and the prevention of cruelty to animals. Like the income tax deduction, certain organizations that foster national or international amateur sports competition may also qualify. Unlike the income tax charitable deduction, these organizations need not have applied for and received formal recognition from the IRS, nor must they be organized or created under the laws of the United States. However, no part of such an organization's net earnings may inure to the benefit of any individual and it must not violate Internal Revenue Code prohibitions against attempting to influence legislation and participating in political campaigns.

For non-resident alien donors, gifts to corporate charities are deductible for gift tax purposes only if the recipient is a US domestic corporation. Gifts to non-corporate charities are deductible as long as the recipients use the gifts within the United States exclusively for the enumerated charitable purposes.

Estate Tax Deduction for Contributions to US and Foreign Charities

For US citizens and residents, a decedent's worldwide estate is subject to US estate tax. For non-resident aliens, the value of a decedent's US situs property owned at death is subject to US estate tax. US situs property consists of US real estate and tangible property physically located in the United States, and securities or obligations issued by US persons or entities (for further details please see the Overview (March 2006)). In determining the taxable estate of any US citizen, resident or non-resident decedent, a deduction is available for bequests to US and foreign charities, with certain limits on charitable bequests of non-resident decedents. Like the gift tax, the amount of the estate tax charitable deduction is unlimited.

For citizen and resident decedents, in addition to unlimited bequests to US qualified charities, bequests to foreign charities are deductible provided that the charity is operated for charitable, scientific, literary or educational purposes, or for the prevention of cruelty to children or animals. For bequests to corporate charities, such purposes include the encouragement of art and gifts to certain organizations that foster national or international amateur sports competition. The recipient organization need not have applied for and received formal recognition of charitable status from the

IRS, nor must it be organized or created under the laws of the United States. Prohibitions on individuals not benefiting from earnings and restrictions on lobbying and political campaigns are similar to those under the gift tax rules.

For non-resident alien decedents, bequests to corporate charities are deductible only if the recipient is a US domestic corporation. Bequests to non-corporate charities are deductible only if the recipients use the bequest exclusively within the United States. The enumerated charitable purposes for the deduction available to estates of non-residents do not expressly include organizations that foster national or international amateur sports competition.

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