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Furthering Unrestricted Grantmaking Across Borders: Proposals for Updated Tax Law Guidance

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Abstract: This article discusses where US tax law falls short in facilitating unrestricted giving from US foundations to non-US non-governmental organizations (NGOs). Current tax law mechanisms for foundations and donor advised funds to make unrestricted grants to NGOs in other countries are severely limited and US-centric. Some of these rules have no context outside of the US, and ultimately stifle rather than facilitate philanthropy in favor of legitimate charitable organizations. This topic is particularly relevant now as more funders embrace "trust-based philanthropy" and other giving practices that respect nonprofit organizations' ability to choose how to spend grant funds effectively. If US tax law does not take into account more ways in which US funders can support legitimate charitable endeavors globally, we risk further enhancing the wealth gap between countries and reducing the potential for international cooperation and diplomacy. Rather than providing more paths to recognize legitimate non-US NGOs as acceptable grantees, the Treasury Department continues to add new kinds of vetting and due diligence requirements on US funders and their overseas grantees. The result is that the cost of compliance and monitoring often outweighs the benefits of making overseas grants, particularly by smaller foundations and donor advised funds. This article provides examples of where US tax law currently falls short in recognizing and promoting ways to give unrestricted grants internationally. It also presents concrete proposals for helping to bridge this gap in a way that recognizes international differences and increases the potential for unrestricted giving without sacrificing compliance obligations.

Keywords: tax-exempt; 501(c)(3); international; unrestricted; philanthropy; regulations

The trend toward trust-based philanthropy is a welcome development in the nonprofit sector. Studies have shown that organizations are able to better maintain sustainable operations when given the latitude to spend grants on overhead or other needs often

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excluded from restricted grant funding.[1] And yet, US tax law does not create ready mechanisms to allow non-US grantees to benefit from the ideas captured in the term "trust-based" philanthropy, no matter how vetted the organization may be.

Even with existing legal mechanisms in place, too many legitimate non-US charities are legally unable to receive unrestricted funding. At the same time, US private foundations and donor advised funds, as well as their non-US grantees, are increasingly saddled with due diligence obligations. Some of these obligations may be unachievable for local organizations as a result of cultural differences in legal frameworks or repressive measures brought about by authoritarian regimes, as further discussed herein.

There are practical ways for the Internal Revenue Service (IRS) to refine existing guidelines around international grantmaking that better support legitimate civil society actors without sacrificing the compliance concerns that regulators aim to tackle through such vetting requirements.

The recommendations stated in this article are limited to the restrictions in place that apply to U.S. private foundations and sponsoring organizations of donor advised funds. Public charities (other than those sponsoring donor advised funds) are not subject to the same compliance requirements discussed in this article, and thus have the opportunity already to give overseas with less compliance overhead. And while US public charities giving grants overseas – including fiscal sponsors and similar intermediaries that do not sponsor donor advised funds – account for a notable portion of overseas philanthropy, the total amounts granted by such entities does not match that of private foundations and donor advised funds.[2]

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1 *See, e.g.*, Wiepking, P., & De Wit, A. (2023). Unrestricted funding and nonprofit capacities: Developing a conceptual model. *Nonprofit Management & Leadership*, *34*(4), 801–824. https://doi.org/10.1002/nml.21592 ("There is initial empirical support for the assumption that fewer donor-imposed restrictions on funding have positive outcomes for nonprofit capacities, including the ability to better deal with external shocks such as presented by the COVID-19 crisis.").

2 The largest U.S. charities giving overseas who are not operating donor advised funds have annual budgets of between $1 and $3 billion USD; whereas, the Bill & Melinda Gates Foundation alone distributes upwards of $5b USD in overseas grants annually. *See* DevelopmentAid. (2023, August 10). Top 10 US fund-raising charities specializing in international aid. *DevelopmentAid*. https://www.developmentaid.org/news-stream/post/165960/top-10-us-fund-raising-charities-specializing-in-international-aid; *Annual Report 2023*. (2024, August 26). https://www.gatesfoundation.org/about/financials/annual-reports/annual-report-2023; Lawrence, S., Nicole Bronzan, Brian Kastner, Em Moses, Natalie Ross, Grace Sato, & David Wolcheck. (2022). The State of Global Giving by U.S. Foundations 2022 EDITION. In The State of Global Giving by U.S. Foundations 2022 EDITION. Candid. https://cof.org/sites/default/files/documents/files/private/2022-state-global-giving-US-foundations.pdf; s*ee also* Di Mento, M. (March 5, 2024) *Philanthropy 50*. The Chronicle of Philanthropy. https://www.philanthropy.com/article/the-philanthropy-50/#id=browse_2023 (noting that megadonors primarily give to and from their US foundations and donor advised funds).

1 The Value of Unrestricted Grantmaking

US funders have begun to embrace what the nonprofit sector has long advocated: that funds invested in overhead and infrastructure are just as valuable, if not more valuable, than funds directed to specific charitable programs.[3] According to a recent article published by the Center for Effective Philanthropy, "It is one of the ideas with the greatest currency in philanthropy right now: More funders need to make large, unrestricted grants, and then trust nonprofits to use them well."[4] CEP also reported in a survey of nonprofit leaders that more "funders are embracing more trust- and relationship-based investment … and then backing it up with unrestricted support."[5]

Experts in philanthropy agree that this trend allows organizations to be funded in more meaningful ways that ensure their long-term sustainability: "When they get multi-year unrestricted funding, nonprofits can become more financially stable. That increases their ability to respond when crises arise or situations change, while making it easier for them to innovate and take risks."[6] While the sector increasingly recognizes and values unrestricted giving mechanisms, US tax law has yet to allow for funders to do so in ways that benefit non-US grantees without substantially limiting their eligibility for such funding.

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3 While a longstanding donor norm has been to measure nonprofit efficiency by the ratio of overhead to "direct expenses," research is showing that efforts to minimize overhead may actually be preventing nonprofits from fully achieving their missions. *See* Mitchell, G. E., & Calabrese, T. D. (2023). The Hidden Cost of Trustworthiness. Nonprofit and Voluntary Sector Quarterly, 52(2), 304–326. https://doi.org/10.1177/08997640221092794 ("Scholars have surmised that excessive overhead minimization is likely harming the abilities of nonprofits to advance their missions."); *see also* Lecy, J. D., & Searing, E. A. M. (2015). Anatomy of the Nonprofit Starvation Cycle: An Analysis of Falling Overhead Ratios in the Nonprofit Sector. Nonprofit and Voluntary Sector Quarterly, 44(3), 539–563. https://doi.org/10.1177/0899764014527175.

4 *See* Staff, C., & Staff, C. (2024, June 7). *The Impact of large, Unrestricted Grants on Nonprofits: A Five-Year View*. The Center for Effective Philanthropy. https://cep.org/the-impact-of-large-unrestricted-grants-on-nonprofits-a-five-year-view/.

5 See Kustka, J., & Kustka, J. (2024, June 20). *State of Nonprofits 2023: What funders need to know*. The Center for Effective Philanthropy. https://cep.org/report-backpacks/state-of-nonprofits-2023-what-funders-need-to-know/?section=intro.

6 *See* Shaker, G., & Wiepking, P. (n.d.). *What is unrestricted funding? Two philanthropy experts explain*. The Conversation. https://theconversation.com/what-is-unrestricted-funding-two-philanthropy-experts-explain-164589.

2 US Legal Definitions and Constraints in the International Context

US tax law defines what it means to be "charitable" – and thus tax-exempt – broadly. It includes an expansive swathe of activities that benefit the public at large, or subsets of the general public, including the promotion of education, research, religion, culture, health, human and civil rights, animal welfare, erection of public monuments, elimination of prejudice and discrimination, etc. "The term charitable is used … in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in [Internal Revenue Code ("Code")] section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of charity as developed by judicial decisions."[7]

However, for a non-US charity to be granted unrestricted funding by a US private foundation or donor advised fund, it must further look and act like a US public charity, including – in most cases (with some exceptions described later) – by meeting a complex income measurement demonstrating compliance with a US-defined "public support" test. In the US, these requirements are part of what it means to benefit from an income tax exemption. But for non-US charities, these rules are particularly limiting, as they were created to combat US-specific abuses, which often have little context beyond US borders.[8] Instead, the requirements prevent many effective charitable organizations from receiving US funds to support uniquely valuable work. With only restricted funding available, necessitating more onerous oversight procedures by both the funder and the grantee,[9] many smaller funders and

7 Treas. Reg. § 1.501(c)(3)-1(d)(2).

8 Some examples of these US-specific abuses are further detailed later in this article, and include: the fear that foundations may transfer tax-exempt US dollars between controlled tax-exempt entities indefinitely, without spending them on charitable programs; or the potential for abuse from grantmaking foundations that do not rely on public sources of funding. The 1969 Tax Reform Act, which established distinctions between private foundations and public charities, operating and non-operating foundations, and many of the related rules addressed in this article, was primarily an attempt to confront such perceived abuses. *See* A History of the Tax-Exempt Sector: An SOI Perspective. (2008). *In Statistics of Income Bulletin*. https://www.irs.gov/pub/irs-soi/tehistory.pdf ("By the 1960s, there was a growing perception among lawmakers that private foundations, with their small networks of financers and administrators, were less accountable to the public than traditional charities."). It is unclear how widespread these concerns were or are in practice.

9 Without an equivalency determination (discussed below) or a ruling from the IRS concluding that the foreign organization is described in Code section 501(c)(3) and classified as a public charity, the only way for a private foundation or donor advised fund to make grants to non-US organizations is by exercising expenditure responsibility. Expenditure responsibility is an oversight and diligence procedure that requires: (i) conducting and documenting a pre-grant inquiry on the recipient organization; (ii) a written grant agreement that: (a) restricts use of the grant to a specific charitable

grantees opt against pursuing the grant at all. The rules thus stifle rather than promote effective international giving.

Moreover, applying a US lens to what it means to be "operating for the public good" in a non-US context exacerbates the existing power imbalance in global development that remains in many ways anchored in its colonial past. US tax law effectively mandates donor control over any funds that flow to organizations who are not identically structured as US organizations. Locally led organizations formed precisely to combat local problems are thus not given the autonomy to fully determine how to expend grants from US donors.

While it is true that individual donors may still make unrestricted grants, and public charities (as opposed to private foundations and donor advised funds) have much more leeway in administering unrestricted grants abroad, neither option comes anywhere close to the amounts granted out of private foundations and donor advised funds. This is a natural outcome of the fact that individual donors cannot claim an income tax deduction on grants to non-US entities (without 501(c)(3) status); and public charities that are not sponsoring organizations to donor advised funds[10] do not typically have adequate wealth to maintain large grantmaking operations without themselves defaulting to private foundation status.[11] Those that do tend to be large public charities acting as intermediaries, who are required to downstream the same compliance requirements that are placed on them by risk-averse government donors, which are substantially more onerous than that of private funders.[12] Thus, the vast majority of philanthropic funds from the US to other countries comes from

project (in most instances); (b) prohibits or restricts using the grant for certain expenses, such as efforts to influence legislation and, in most cases, re-grants; (c) requires specific reporting back to the funder; and (iii) in the case of a private foundation funder, specific disclosures on the foundation's annual information return on Form 990-PF.

10 Donor advised funds are funds held by public charities acting as sponsoring organizations. While the owner of donor advised funds is the public charity, the tax laws impose restrictions on grantmaking from donor advised funds that would not otherwise be applicable to a public charity making international grants. These restrictions generally (but not identically) match the restrictions applicable to private foundation grantmaking.

11 US public charities must also meet a public support test to avoid being classified as private foundations, which means that they cannot effectively rely on one or a small number of large grants from individuals, businesses, or private foundations, and cannot exclusively engage in grantmaking.

12 *See, e.g.*, Chikoto, Grace L., "Government Funding and INGO Autonomy: From Resource Dependence and Tool Choice Perspectives." Dissertation, Georgia State University, 2010. doi: https://doi.org/10.57709/2853049; Stoddard, A., Czwarno, M., Hamsik, L., InterAction, & Humanitarian Outcomes. (2021). *NGOs & RISK: Managing Uncertainty in Local-International Partnerships* [Report]. https://www.humanitarianoutcomes.org/sites/default/files/publications/riskii_partnerships_global_study.pdf.

private foundations and donor advised funds, rather than from individual donors or public charities.[13]

3 How Private Foundations and Donor Advised Funds Make Grants to Foreign Charities

For US private foundations and donor advised funds, there are generally four primary options for making a grant within US tax law parameters:

1. The grantee is a foreign charity who has applied for and received a determination from the IRS that it is described in Code section 501(c)(3) and classified as a public charity.

The first of these options – applying directly with the IRS for tax-exempt status – has little value to non-US organizations with minimal US income, since the purpose of the designation is principally to exempt the entity from US income tax and entails annual reporting obligations with the IRS.

2. The grantee is a foreign government agency or instrumentality, or a designated public international organization.

The Treasury Regulations provide that neither expenditure responsibility nor an equivalency determination is required if a grant is made to "a foreign government, or any agency or instrumentality thereof, or an international organization designated as such by Executive order under 22 U.S.C. 288, even if it is not described in section 501(c)(3)." All such grants must be "made exclusively for charitable purposes as described in section 170(c)(2)(B)."[14]

Foreign government agencies and instrumentalities can include everything from municipalities to public schools and thus is broader than conventional government bodies, but still not a large overall proportion of civil society actors. The list of international organizations designated by US Executive order – which includes intergovernmental bodies like the United Nations and the World Trade Organization – remains fewer than 100 specialized entities, and is not a list that is commonly updated.[15] The vast majority of non-US organizations seeking US grant funds are non-governmental and would not qualify for any of these designations. Moreover, as described, grants to

13 *See, e.g.*, Di Mento, M. (March 5, 2024) *Philanthropy 50*. The Chronicle of Philanthropy. https://www.philanthropy.com/article/the-philanthropy-50/#id=browse_2023 (noting that megadonors primarily give to and from their US foundations and donor advised funds).

14 Treas. Reg. § 53.4945-5(a)(4)(iii).

15 *See* 22 USC 288; 19 CFR 148.87.

governments and international organizations must be restricted to charitable purposes, which, in practice, means that many funders choose to place overhead caps and other limitations on grants to such entities to ensure that the funds are truly restricted.

3. The funder exercises "expenditure responsibility," tracking the funds through a restricted grant with reporting and oversight requirements throughout the life of the grant, and until all funds have been expended.

The third option – expenditure responsibility – is, as previously described, an onerous process requiring pre-and post-grant disbursement diligence, segregation of funds, and reporting throughout the life of the grant and for as long as funds are in use. It assumes that the funds must be tracked start to finish, and, as one practitioner writes, the "increased … diligence requirements for grants to … foreign charities (known as 'expenditure responsibility') … ultimately had the effect of deterring foundations from making these grants, irrespective of need."[16]

4. The recipient may be a non-US public charity recognized via an opinion issued by a US qualified tax practitioner for a limited period as "equivalent" to a 501(c)(3) public charity (known as an "equivalency determination").[17]

The fourth option – an equivalency determination – is viable for non-US organizations with traditional NGO or public benefit statuses in most countries, and who are also funded by a diverse set of donors. It is typically the preferred option for funders as it is less onerous for both them and their grantees, and has the added benefit of allowing unrestricted grants. For many non-US organizations, however, including ones organized and operated for charitable purposes, an equivalency determination may be unfeasible for reasons outside the organization's control. Below are a few salient examples.

4 Where Equivalency Determination is not an Option

1. Local nonprofit laws and shareholder membership structures.

To be recognized as equivalent to a 501(c)(3) public charity, an organization must be organized in a way that prohibits it from expending funds, either during the life of

16 Orol, Zoey F. (2021) *The Failures and the Future of Private Foundation Governance. ACTEC Law Journal*: Vol. 46: No. 2, Article 3. https://scholarlycommons.law.hofstra.edu/acteclj/vol46/iss2/3.

17 *See* Petit, S.; Lackritz-Peltier, M. (July/August 2016) *Final Regulations on Foreign Public Charity Equivalency Determinations*. Taxation of Exempts. https://www.adlercolvin.com/wp-content/uploads/2017/12/Final-Regulations-on-Foreign-Public-Charity-Equivalency-Determinations-00834838xA3536.pdf.

the organization or in the event of its dissolution, for purposes that are not deemed charitable. On its face, this is already what most nonprofit public benefit organizations around the world are required to do. However, local legal regimes or bureaucratic governance processes may prevent them from meeting the strict requirement. A common example is in the distinction that many nonprofit laws in other countries make between a member or shareholder's "initial capital contribution" and any other kinds of payments or contributions.

Nonprofit organizations in the US may not have shareholders: the concept of equity holders is contrary to the notion that an organization's members or founders have no ownership rights to a nonprofit organization's assets. There are, however, laws in other countries that recognize, and sometimes even require, a nonprofit entity type with shareholders. These laws do not permit shareholders to receive dividends or interest, but they do recognize that an individual may make an "initial contribution" to a nonprofit organization to capitalize its operations. This payment is neither an equity stake – which, in the US context, implies a claim to earnings – nor a charitable contribution. In fact, many of these laws specifically state as much, distinguishing that nonprofit shareholders have no right to the organization's assets or earnings, and that an "initial capital contribution" is not the same as a donation. Instead, such payments may be more aptly likened to a loan or conditional grant, as they may be utilized during the life of the organization, but must be returned in the event the organization dissolves. They also serve as evidence of shareholders' commitment to the organization's viability and are typically nominal in amount.

Nonprofit shareholding structures of this type exist in multiple countries, including, without limitation, France,[18] Germany,[19] Greece,[20]

18 *See* Associations.gouv.fr. (2024, April 29). *Dissolution – associations.gouv.fr*. https://www.associations.gouv.fr/1006-dissoudre-une-association.html (as translated): "Contributions are goods made available to the association on a permanent basis for an indefinite period, without it being a donation. The statutes, or the general meeting when it is called upon to decide on the transfer of assets, may provide that contributions made by certain members be returned to them." The site also explains, however, that "[m]embers cannot claim reimbursement of their contributions," thereby distinguishing between initial capital contributions and any other kind of contribution.

19 *See The Fiscal Code of Germany*. (n.d.). https://www.gesetze-im-internet.de/englisch_ao/englisch_ao.html, §55(1)4, at https://www.gesetze-im-internet.de/englisch_ao/englisch_ao.html ("Where the corporation is dissolved or liquidated or where its former purpose ceases to apply, the assets of the corporation *in excess of the members' paid-up capital shares and the fair market value of their contributions in kind* may be used only for tax- privileged purposes (dedication of assets)." (emphasis added)).

20 *See* Αστικός κώδικας. (Civil Code) (2024, March 14). Lawspot. https://www.lawspot.gr/nomikes-plirofories/nomothesia/astikos-kodikas Arts. 741-742 (as translated) (mandating that shareholders make contributions to form the company) and Art. 780 ("During the liquidation, the joint debts of the

Lithuania,[21] Jordan, Madagascar,[22] Monaco,[23] and Palestine.[24] Such structures permit a nonprofit organization to have a viable starting investment, which is restricted to the organization's operation: for this reason, it is returned to the shareholder in the event of the organization's liquidation. In each of these countries, the law is equally clear that, as nonprofit entities, the organizations' assets must be restricted to the accomplishment of their purposes, and not distributed for any reason other than in furtherance of its charitable operations or as payment for services rendered.

By way of example, under Jordan's Regulation No. 60 of 2007 for Non-Profit Companies, objectives of nonprofit companies must be "to provide social, humanitarian, health, environmental, educational, cultural, athletic, or any similar services of non-profit nature approved by the overseer [of companies]."[25] However, the Regulation also mandates that:

> The funds of the company and its remaining assets after liquidation [are managed] as follow[s]:

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partners towards third parties, as well as those existing between the partners, are first paid off, and then the contributions are returned.") No exceptions are made for nonprofit companies.

21 *See* Law on Public Institutions of the Republic of Lithuania (05/01/2024 – 08/31/2024). State Gazette, 19-07-1996, No. 68-1633, Art. 17.10. https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/TAIS.29578/bYZuFeSGqr (as translated) ("Once all creditors' claims have been satisfied, the remaining assets of the public body are returned to the shareholders, the total value of which may not exceed the shareholders' capital. The assets returned to the shareholders are distributed in proportion to the value of their contributions. The remaining unallocated assets shall be transferred to other public legal entities registered in the Register of Legal Entities ….").

22 *See* Associations Law, Art. 11. *Document provided by the International Center for Not-for-profit Law (ICNL).* https://www.icnl.org/wp-content/uploads/Madagascar_60133.pdf?_ga=2.10552820.1325978229.1576696483-179664486.1570054765 ("When the general assembly of the association decides on the property's transmission, whatever the way of transmission is, it cannot be transferred even partially to the shareholders, with exception to the recovery of their shares.").

23 *See* Loi n° 1.355 du 23 décembre 2008 concernant les associations et les fédérations d'associations (n.d.). Legimonaco. https://legimonaco.mc/tnc/loi/2008/12-23-1.355/ (as translated), Arts. 20-1 and 3(6) (providing simultaneously that an association's funds be "fully accounted for" and "spent in accordance with the association's corporate purpose" and that, on dissolution, "members cannot be allocated any share of the association's assets *other than the recovery of contributions*." (Emphasis added)).

24 *See* Decree Law No. (42) of 2021 AD, at http://legal.pipa.ps/files/server/%D9%82%D8%A7%D9%86%D9%88%D9%86%20%D8%A7%D9%84%D8%B4%D8%B1%D9%83%D8%A7%D8%AA.pdf Click to follow link.">http://legal.pipa.ps/files/server/%D9%82%D8%A7%D9%86%D9%88%D9%86 %20%D8%A7%D9%84%D8%B4%D8%B1%D9%83%D8%A7%D8%AA.pdf, which requires that nonprofit companies be organized as joint-stock companies with shareholders who have no rights to net returns or profits, but whose initial contributions may be returned to them in the event of dissolution.

25 *See* Regulation No. 60 of 2007 for Non-Profit Companies, Art. 5. *Document provided by the International Center for Not-for-profit Law (ICNL).* https://www.icnl.org/wp-content/uploads/Jordan_Reg-60-2007-En.pdf.

> A. The partners and shareholders are given back their actual shares of the capital at the moment of establishment, and if the assets are less than the original shares, they are distributed with respect to the original ratio of participation.
>
> B. If the assets are more than the capital, the remainder devolves to the Scientific Research Fund, any other non-profit company, public institutions or NGOs with similar objectives by a decree of the minister, based on the reference of the overseer.[26]

Founders of such nonprofit companies don't intend to collect their initial contribution any more than they intend for the organization to dissolve during their lifetimes. And yet, the law requires that such language appear in their governing documents, typically prohibiting them from being recognized as equivalent to a US public charity under an equivalency determination. As noted above, this same legal structure exists in many other countries of disparate legal systems and geographies.

2. Non-US charities and the public support test.

To be recognized as equivalent to a 501(c)(3) public charity, in most cases, a non-US organization must further be supported by a diverse donor base such that it be considered accountable to the public. Notably, while this test is not required for certain charitable entity types deemed to be acting inherently in the public interest, such organizations make up a much smaller share of the overall distribution of public charities in the US and abroad; they include schools, religious congregations, hospitals, medical research organizations, and supporting organizations.[27]

This test is known as the public support test, which measures an organization's "public support" status by examining its income sources over the immediately preceding five fiscal years. The purpose behind the test, which stems from the US Code, is to distinguish between 501(c)(3) private foundations, whose income derives entirely from a limited number of individuals, families, or businesses, and 501(c)(3) public charities, who must actively seek funding from the public.

US tax law assumes that an entity whose existence depends on fundraising is more inherently accountable to the general public than an entity whose funding is guaranteed via an endowment or other single revenue stream. Therefore, it is not sufficient for an entity to be organized and operated exclusively for charitable

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26 *See id.* at Art. 16.

27 *See* Treas. Reg. § 170(b)(1)(A); *see also A Brief Introduction to Public Charity Classifications* (2017, May 1). NGOsource. https://www.ngosource.org/a-brief-introduction-to-public-charity-classifications; *Changing the Landscape of International Philanthropy: NGOsource 10-Year Retrospective* (2023). NGOsource. https://tenyears.ngosource.org/NGOsource10YRFinal_2024.pdf, page 37 (showing that more than 83 % of all equivalency determinations requested over a ten-year period were for organizations qualifying under a public support test rather than one of the charitable entity types considered inherently accountable to the public).

purposes to be recognized as a 501(c)(3) public charity or its equivalent: the organization must further benefit from a diverse donor base.

The US public support test is unique to US tax law. In no other country is the same test applied to charitable entities. For this reason, a non-US charitable organization would have no reason to seek diverse funding if it already had a guaranteed funding stream from one or two large private donors. Indeed, such an organization might even deem it inappropriate to expend resources on fundraising in such circumstances. And yet, it would be unable to qualify as equivalent to a US public charity without receiving significant funds from other sources to diversify its revenue.

A valid argument might be made that the public support test has value beyond just the US context. Despite its uniqueness, its ultimate aim is to measure accountability by concluding that reliance on broad public support necessitates appealing to the public. If an organization is solely funded by a single donor, how can one know that the community itself takes any interest or benefit from the organization's programs? What might prevent the sole donor from exercising control over the funds in that donor's exclusive interest?

Even assuming the public support test has relevance in a non-US context, however, it is unfair to subject non-US organizations to it where it has no equivalent in their home countries. Moreover, while certainly diverse public funding is one way to measure community support, it should not be treated as the exclusive method of doing so. Particularly in lower-income communities or communities without a tradition of monetary-based philanthropy, assuming that public support can only be evidenced by monetary contributions overlooks the value of volunteerism, local partnerships, and community trust-building through non-monetary means like community input mechanisms. Might we consider that diversity of public support may be more appropriate when measured via non-monetary means?[28]

A notable example of how a non-monetary measure of public support further harms non-US organizations are those entities who have operated for many years on an entirely volunteer basis, with no income. Theoretically, a volunteer-run organization without expenses is evidence of an organization's ability to operate beneficial community programs without risking resource waste or asset misuse. In recent years,

28 Even in the US context, precedent exists for recognizing public accountability through non-monetary measurements. Specifically, the Treasury Regulations articulate a set of facts and circumstances that organizations may use to demonstrate they are accountable to the public, even though they may have "low" public support. The "10 % facts and circumstances test" asks organizations with at least 10 % public support but less than 33 1/3 % to otherwise demonstrate that they actively fundraise, maintain a diverse board independent of their donors, and carry out regular programs benefiting the general public, among other things. *See* Treas. Reg. § 1.170A-9(f)(3); *see also The 10 % Facts and Circumstances Test* (2024, October 21). NGOsource. https://www.ngosource.org/the-10-facts-and-circumstances-test.

organizations engaging directly with the public may have had to suspend activities during the COVID-19 pandemic, resulting in several years of inactivity. This includes service-delivery organizations and arts organizations like community theaters. And yet, such organizations also fail the public support test, since no income at all results in a 0 % public support status, which is even lower than an organization with a single funder.

3. Repressive regimes and the stifling of philanthropic funds.

A third example presents itself in various jurisdictions where repressive or authoritarian regimes restrict and penalize civil society in an effort to silence opposition. Such governments often enact laws preventing organizations from receiving foreign funds or from even registering as legal entities without either renouncing programs or subjecting themselves to draconian state oversight. Organizations in these circumstances experience government raids on their facilities, asset seizure, and penalizing taxes for often vague, unstated, or fabricated reasons. Organization officials risk fines and ongoing harassment, if not jail time or exile. This phenomenon – often referred to as *closing civic spaces* – is reportedly on the rise,[29] as regimes mimic the success of the strategy in other jurisdictions.

The result of authoritarian oppression of civil society is often that local organizations are no longer able to organize under traditional nonprofit entity types, or if they are, they may be reluctant to expose their staff to harm or their assets to seizure. As such, their eligibility for foreign funds is doubly stifled, since US private foundations and donor advised funds can no longer recognize them as 501(c)(3) equivalent for purposes of awarding unrestricted grants.

A stark example of this phenomenon may be seen in LGBTQ+-serving organizations in Uganda, where President Yoweri Museveni signed the 2023 Anti-Homosexuality Bill, among the most restrictive of its kind in the world. The Bill has been widely condemned,[30] including by multilateral agencies like the United Nations[31] and the World Bank.[32] As reported by NPR, "Ugandans who engages in gay

29 "In 2020, only 12.7 per cent of people around the world live in countries with an open or narrowed civic space rating, a significant decline from the 17.6 per cent who did so in 2019," according to CIVICUS. The situation was exacerbated by the COVID-19 pandemic, which provided some governments with a "pretext for repression." *See Civic Space on a downward spiral – Civicus Monitor 2020*. (n.d.). https://findings2020.monitor.civicus.org/downward-spiral.html#:~:text=Civic%20space%20conditions%20are%20declining,cent%20to%2018.3%20per%20cent.

30 *See Reactions to new Ugandan anti-LGBTQ law* (2023, May 30). Reuters. https://www.reuters.com/world/africa/reactions-new-ugandan-anti-lgbtq-law-2023-05-29/.

31 *See UN rights experts condemn Uganda's 'egregious' anti-LGBT legislation* (2023, March 29). UN News. https://news.un.org/en/story/2023/03/1135147.

32 *See* Shalal, A.; Singh, K. (2023, August 9). *World Bank halts new lending to Uganda over anti-LGBTQ law*. Reuters. https://www.reuters.com/world/africa/world-bank-says-ugandas-anti-lgbtq-law-violates-its-values-2023-08-08/.

sex can receive life in prison, while anyone who attempts to have same-sex relations can face 10 years in prison. … Widespread anti-gay sentiment in Uganda and the threat of imprisonment has forced many in the LGBTQ community to flee the country over the past few years. The new law has sent many others into hiding."[33] According to the Rainbow Fund, "members of the LGBTQ+ community [a]re being dismissed from their jobs, rejected by their families, and made homeless by their landlords."[34]

With homosexuality criminalized, Ugandan NGOs previously engaged in supporting the LGBTQ+ community have had their registrations revoked, or simply not renewed.[35] As a result, they are forced to operate as either unincorporated community groups with no formal legal status, or as for-profit entity types with less government oversight. Both situations effectively disqualify them from an equivalency determination.

5 Expanding Unrestricted Grantmaking to Foreign Charitable Organizations

The above three examples demonstrate why many valid charitable non-US organizations are excluded from the possibility of receiving unrestricted funding from US foundations and donor advised funds. Without the viability of an equivalency determination, only funders willing to exercise expenditure responsibility – which comes at a higher cost and burden to both parties – may continue to fund them, and only by further restricting application of the funds to specific charitable projects. In other cases, US funders may opt to give to large international NGOs from the global minority,[36] further preventing local organizations from benefiting from resources to help them attain self-determined outcomes. This reality is evidenced through the failure of international development donors to give more than a fraction of their

33 *See* Northam, J. (2023, May 29). *A new anti-gay law in Uganda calls for life in prison for those who are convicted*. NPR. https://www.npr.org/2023/05/29/1178718092/uganda-anti-gay-law.

34 *See Uganda LGBTQ+ — Rainbow World Fund*. (n.d.). Rainbow World Fund. https://www.rainbowfund.org/uganda-lgbtq.

35 *See* Nyeko, O. (2022, August 12). Uganda bans prominent LGBTQ rights group. *Human Rights Watch*. https://www.hrw.org/news/2022/08/12/uganda-bans-prominent-lgbtq-rights-group.

36 In 2021, according to the Inter-Agency Standing Committee, only 2 % of funding for humanitarian action went directly to local actors. This statistic is problematic not only because of its paucity, but because it represents half the percentage recorded in 2020, when direct funding to local actors peaked at 4 %. *See Grand Bargain Annual Independent Report 2022 | IASC*. (2022, June 22). https://interagencystandingcommittee.org/grand-bargain-official-website/grand-bargain-annual-independent-report-2022; Metcalfe-Hough, V., Fenton, W., Saez, P., & Spencer, A. (2021). The Grand Bargain in 2021: an independent review. In Overseas Development Institute, *HPG Commissioned Report*. ODI. https://media.odi.org/documents/Grand_Bargain_2022_ExecSummary_PDzKvF7.pdf.

overall funds directly to local actors, despite setting explicit goals to increase amounts flowing to local and national organizations.[37]

It is also worth noting that compliance with tax-exempt law is not the only vetting required by funders giving internationally. The US Office of Foreign Assets Control (OFAC) further mandates that funders cross-check grantees and their controlling officers and affiliates against existing international watchlists in order to avoid unintentionally funding sanctioned persons. This asset vetting comes on top of any program-specific diligence that most institutional funders also undertake before awarding a grant – examining such things as an organization's relevant experience, the suitability of its mission, its capacity to manage the grant, and other factors intended to ensure that the funder's investment matches the goals of its organizing articles and mission. As a result, even those grantees receiving unrestricted grants are still subject to multiple other vetting requirements, made doubly onerous if the funds additionally must be tracked and reported against under expenditure responsibility.

The purpose of the tax law requirements on US private foundations and donor advised funds is to ensure that tax-exempt US revenue is expended exclusively on charitable endeavors within the meaning of the Code. As already established, the definition of "charitable" for these purposes is broad enough to be met by many of the organizations described above. The reason such organizations are ineligible for unrestricted funding is instead due to forces outside of their control: namely, their funding is not sufficiently diverse to meet the US public support test, or local laws or regimes prohibit them from legally or safely registering under a suitable legal entity type.

Expanding our understanding of what it means to be legitimately organized and operated as a charity in other countries and contexts is critical for US philanthropy to continue to support vital charitable projects globally.

6 Proposals for Regulatory Guidance

The IRS issues revenue procedures in order to clarify and propose rules for taxpayers to comply with the Code and related statutes, treaties, and regulations. Revenue Procedure 2017-53, for example, promulgates guidelines that qualified tax

37 *See* Metcalfe-Hough, V., Fenton, W., & Manji, F. (2023). The Grand Bargain in 2022: an independent review. In Overseas Development Institute, *HPG Commissioned Report*. Overseas Development Institute. https://media.odi.org/documents/HPG_report-Grand_Bargain_2023_exec_summary_eZdqeQx.pdf ("Despite this progress, the potential of the Grand Bargain to address the political barriers to change in other areas is still to be realised. There was no concrete progress towards a more demand- rather than supply-driven humanitarian response; there is an ongoing failure to substantively increase funding to local and national actors; and quality funding is still insufficient to enable the desired step-change in efficiencies and effectiveness.").

practitioners may use for preparing written advice on which a domestic private foundation ordinarily may rely in making an equivalency determination, more broadly defined in the Treasury Regulations. The IRS could equally issue a Revenue Procedure clarifying when an equivalency determination may account for non-US laws and circumstances that may otherwise appear to disqualify an organization from qualifying as equivalent to a US public charity. A few possible examples follow.

1. Waiver of public support test for non-US controlled foreign charities or spend-down requirements instead of the public support test.

As described above, the US public support test applies US-specific concerns to a non-US context, and in this way hinders rather than supports the flow of philanthropic dollars to legitimate charitable causes. Given that the test is intended to prevent US foundations from transferring tax-exempt funds among themselves, without ever distributing them or paying taxes on them, the intent of the rule could be met internationally by applying it only in situations where US donors control the non-US entity (through majority board control, for example). If the non-US charity is not controlled by a US donor, then the risk of transferring non-taxable funds that are never distributed for charitable purposes goes away. For such entities, a public support test might be waived to prevent penalizing organizations who happen to be funded by a small number of donors but who otherwise clearly meet the facts and circumstances test[38] demonstrating that they are indeed operating charitable programs and not merely distributing grants.

Another possible solution would be to waive the public support test requirement for non-US charities and instead require that the grant funds be redistributed within a given time frame, such as three years after the date of the grant. Such distribution obligation is similar to the out-of-corpus requirement applied when foundations give to other foundations, but without the added requirement to undergo expenditure responsibility, where an organization is clearly organized and operated for charitable purposes. Although the other requirements of an equivalency determination – confirming that the organization is organized and operated for charitable purposes – would still apply, breaking down five years of income under a unique US-specific calculation[39] is by far the most onerous aspect of the process for organizations, even those that have no trouble qualifying on the basis of their revenue. Complications arise due to unique donor and income categories not otherwise tracked and segregated under local accounting requirements. Many of the key

38 *See The 10 % Facts and Circumstances Test* (2024, October 21). NGOsource. https://www.ngosource.org/the-10-facts-and-circumstances-test.

39 *See An Introduction to Public Support Tests* (2017, May 30). NGOsource. https://www.ngosource.org/blog/an-introduction-to-public-support-tests.

terms – like unrelated business income, gross receipts from exempt activities, or taxes levied on the organization's behalf – are wholly foreign to them (as they are to many US charities, incidentally), and make it difficult to identify and segregate them from their financial records.

2. Placing cumulative dollar thresholds that allow for more limited vetting.

Given the numerous due diligence requirements attached to any transfer of funds (of any amount), the cost of compliance generally outweighs the benefits of making small international grants of $10,000 or less. Local organizations in low and lower-middle-income economies could benefit immensely from small operational grants allowing them to initiate or scale programs.[40] Unrestricted "micro-grants" also allow newer organizations to build a track record that will help make them more visible to international funders. Coupling small grants with burdensome restrictions and reporting requirements, however, makes them less effective and less feasible for both the funder and the recipient.

The IRS could issue clarifying guidelines regarding grants to charitable entities that amount to less than a cumulative annual amount by a single funder. Such guidelines are akin to existing IRS rules that exempt public charities with annual gross receipts that are normally $5,000 or less from having to file an application to claim exempt status under Code section 501(c)(3), instead allowing them to self-declare.[41] (Note this is *not* the same exemption as filing under Form 1023-EZ, available for organizations who do not anticipate receiving more than $50,000 in annual gross receipts.)[42] In other words, creating mechanisms to ease compliance for very small charities are already within the confines of the IRS' authority to interpret the Code and Regulations.

The IRS could thus set an annual threshold – such as $10,000 – under which private foundations and donor advised funds could give unrestricted grants to non-US charities based on a reasonable determination that the organization would apply the funds for charitable purposes, absent evidence to the contrary. OFAC and other anti-terrorist vetting rules would still apply, ensuring that a small carve-out of this sort would not raise the risk of asset diversion even in small amounts.

3. Reliance on prior experience as evidence of compliance.

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40 *See, e.g., What micro-grants teach us about funding locally led research – SouthSouthNorth.* (n.d.). https://southsouthnorth.org/what-micro-grants-teach-us-about-funding-locally-led-research/.

41 *See* Pre*sumption of private foundation status | Internal Revenue service.* (n.d.). https://www.irs.gov/charities-non-profits/private-foundations/presumption-of-private-foundation-status.

42 *About Form 1023-EZ, Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code | Internal Revenue Service.* (n.d.). https://www.irs.gov/forms-pubs/about-form-1023-ez.

A third possible way to permit unrestricted giving in situations where non-US charities meet the principal charitability requirements is by enabling foundations and donor advised funds to rely on existing evidence of past compliance. This may be demonstrated internally via grants made, or via shared data repository services that could evidence when an organization has a record of consistently meeting compliance requirements. Similar to establishing a strong credit score or a driving record, non-US charities organized under local legal regimes that may not identically match that of the US charitable sector should be able to demonstrate through more meaningful mechanisms that they are able to steward charitable funds with limited oversight. An organization that is able to both demonstrate genuine public benefit operations and has successfully implemented grants from other funders should be eligible to undergo fewer vetting steps for subsequent grants. IRS guidelines could create streamlined equivalency requirements for organizations and their funders in such situations. A model already exists in NGOsource, a nonprofit repository-based equivalency determination service that significantly reduced the cost of compliance for both US funders and non-US grantees, and was initially blessed by the Treasury and State Departments in 2012.[43] (In the interest of disclosure, the author formerly led the NGOsource program.)

To be sure, the above proposals would offer some limited concessions for non-US charitable organizations that are not otherwise available to US charitable organizations. One might even argue that adopting the proposals could actually encourage formation of NPOs in other countries, or in funding internationally instead of at home. However, such concerns are largely without merit precisely because foreign charities are in such a different position than their US counterparts, as described in this article. Foreign charities do not otherwise track public support in order to benefit from local tax exemption, and thus would have no expectation or alternate reason to diversify their funding. Moreover, there are already ample existing incentives in the US for donors to give to domestic causes and for charities to operate domestically. Current statistics show that at least two-thirds of donations from donors go to domestic causes,[44] which our tax law is designed to encourage. As noted

43 *See Changing the Landscape of International Philanthropy: NGOsource 10-Year Retrospective* (2023). NGOsource. https://tenyears.ngosource.org/NGOsource10YRFinal_2024.pdf.

44 *See* Double the Donation. (2024, March 12). *Nonprofit fundraising statistics to boost results in 2024*. https://doublethedonation.com/nonprofit-fundraising-statistics/#:~:text=For%20every%201%2C000%20fundraising%20emails,their%20charitable%20giving%20via%20email ("33 % of donors give to organizations located outside of their country of residence."); Nonprofits Source. (2023, October 4). *2023 Charitable Giving Statistics, Trends & Data: The Ultimate List of Charity Giving Stats | Nonprofits Source*. https://nonprofitssource.com/online-giving-statistics/; and Sharpe Group. (2020, August 13). *12 interesting fundraising statistics Everyone should know | Sharpe Group*. https://sharpenet.com/interesting-fundraising-statistics-everyone-should-know/ (citing 31 % as the

previously, individuals cannot benefit from tax deductions for charitable contributions to non-US entities. In this way, if giving internationally is already disincentivized, then why must we further require that non-US entities look and act like US charities in order to be trusted with US private funds? Whereas US policy is designed to address US norms and challenges, it is not designed to address those of other countries. Trying to force other countries to meet this model is arguably paternalistic and most certainly inadequate if the goal is to support meaningful local causes.

7 Conclusions

The current legal mechanisms for US private foundations and donor advised funds to give unrestricted grants to non-US charities allows for some deviation from US requirements in that funders can attain an equivalency determination on non-US entities that meet the public charity requirements under US tax law. However, applying this stringent and US-centric lens on what it means to be a "public charity" is adding unnecessary burden and cost to the flow of philanthropic support internationally, at best, and at worst, preventing the flow entirely to small and local organizations, from small funders, or for organizations already threatened by oppressive government regimes.

US funders are just as interested in ensuring that their funds be applied to valid charitable causes as US regulators are. There is no incentive for funders to blindly give away their assets without taking steps to validate that such assets are applied for their intended purposes. Funders should thus be given more latitude in determining a framework that still fully complies with US legal definitions of charity. Rather than continuing to add more vetting requirements – from ever-expanding sanctions checking obligations[45] to changes in donor advised fund public support test

worldwide amount of funds from donors that are spent on organizations outside of their country of residence).

45 *See, e.g.*, Walker, J. *The public policy of sanctions compliance: A need for collective and coordinated international action.* (2022, February 1). International Review of the Red Cross. https://international-review.icrc.org/articles/the-public-policy-of-sanctions-compliance-need-for-collective-action-916

("Recent years have seen an unprecedented growth in the use of sanctions, along with increased innovation in the types of sanctions applied. Most notable is the rise in economic and trade restrictions which tackle a breadth of global concerns, including human rights abuses, conflict, cyber threats, corruption, terrorism and the spread of weapons of mass destruction. The growing prominence of financial sanctions has further generated enhanced scrutiny of their unintended impact, particularly in respect to how sanctions impact the delivery of humanitarian aid."); Subramanian-Montgomery, A. (2023, July 6). Even the Treasury Department admits sanctions don't work.

regulations[46] – the IRS and Treasury Department could refine existing due diligence requirements to better reflect international realities. Instead, such regulations will continue to stifle rather than promote the flow of critical support to civil society in the US and around the world. There are practical ways to improve this status quo that enrich our understanding of civil society while still ensuring that funds are properly stewarded.

Responsible Statecraft. https://responsiblestatecraft.org/2023/04/10/even-the-treasury-department-admits-sanctions-dont-work/; Stirling, D. (2024, May 8). *How trade sanctions became a compliance headache for SMEs*. Raconteur. https://www.raconteur.net/risk-regulation/sanctions-compliance-headache-smes.

46 *See* IRS Notice 2017-53, at https://www.irs.gov/pub/irs-drop/n-17-73.pdf, and NGOsource's comment on the propsed regulations' effect on non-US charities, at https://www.ngosource.org/blog/ngosource-comment-on-irs-notice-2017-73.