Vanderbilt Journal of Transnational Law

Volume 35
Issue 4 *October 2002*

Article 3

2002

Spontaneous Tax Coordination: On Adopting a Comparative Approach to Reforming the U.S. International Tax Regime

Anthony C. Infanti

Spontaneous Tax Coordination: On Adopting a Comparative Approach to Reforming the U.S. International Tax Regime

*Anthony C. Infanti**

ABSTRACT

The excessive complexity of the U.S. international tax regime is well documented. Although many commentators have cited the need for simplification, their proposals often maximize other policy goals at the expense of simplicity. Even reform proposals aimed principally at clarifying the tax code are ordinarily focused on the "internal" complexity of the code, seeking improvements only for U.S. taxpayers struggling with a single complex provision of the code or the baffling interaction of two U.S. rules. This Article focuses on the interaction between U.S. tax law and the rules of other nations, and is intended to illustrate the benefits that spring from viewing the U.S. reform debate from an international perspective. In this pursuit, the Article considers the viability of using the model of international tax coordination to improve efforts to reform the U.S. international tax regime. To test the usefulness of the framework, the Article applies it to a discrete issue of international tax law—the treatment of contributions made by domestic taxpayers to foreign non-profit organizations. After a thorough examination of the tax law of a sampling of nations on this topic, the Article concludes that the proposed framework is a flexible and useful approach to reform that allows for the effective balancing of costs and benefits of reform and may also reduce internal complexity.

---

* Assistant Professor of Law, University of Pittsburgh School of Law. I would like to thank the University of Pittsburgh School of Law for providing financial support for the writing of this Article, and Vivian Curran and Chirsitopher H. Hanna for their helpful comments on previous drafts of this Article. I would like to thank Michael H. Imbacuán for his support while I was writing this Article and for his comments on previous drafts. I would like to thank the library staff at the University of Pittsburgh School of Law (particularly Jon Wichmann of our inter-library loan department) and Ethan Pullman of the University of Pittsburgh GSPIA/Economics library for their help in garthering sources. I would also like to thank John Groman and Christina Cianflone for their research assistance in the preparation of this Article.

TABLE OF CONTENTS

I. INTRODUCTION

From relatively simple roots, the U.S. international tax regime[1] has grown into a farrago of rules that is considered, even by tax attorneys, to be one of the most complex areas in the Internal Revenue Code. As the complexity of this regime has grown, so have the burdens imposed on all of those affected by it:

> There is a general consensus today that the Internal Revenue Code . . . provisions applicable to international income, in particular, are excessively complex. Since passage of the Tax Reform Act of 1986, taxpayers and practitioners have voiced growing concerns that the

---

1. Throughout this Article, the phrase "U.S. international tax regime" is used as a convenient shorthand for the myriad of tax rules that govern the foreign activities of U.S. taxpayers and the U.S. activities of foreign taxpayers.

> international provisions are too difficult to interpret and too costly to apply. Tax administrators and tax policymakers have voiced parallel concerns with the growing costs of administration and the increased difficulty of enforcement.[2]

If this complexity continues to grow unchecked, the burdens imposed on taxpayers, practitioners, and administrators may soon become so onerous that the U.S. international tax regime will simply collapse under its own weight.

Despite the obvious need to reduce complexity, "simplicity always seems to be the forgotten stepchild of income tax policy."[3] In the debate over how to reform the U.S. international tax regime, commentators "[r]outinely [pay] lip service . . . to the idea that the tax law ought to be as simple to comply with and administer as possible; then, after a nod and a wink, vaulting complexity overleaps itself."[4] Even when they have pointedly addressed the need for simplification, commentators have narrowly focused their attention on the "internal" complexity of the U.S. international tax regime. In other words, commentators have generally viewed the regime in isolation, and they have only considered methods for reducing the complexity of individual U.S. rules or of the interaction of one U.S. rule with another U.S. rule.

Such a narrow view of the U.S. international tax regime is, however, out of step with reality. The regime does not operate in isolation, but rather continuously interacts with the international tax regimes of other countries. These interactions inevitably engender conflicts between the U.S. and foreign rules, and these conflicts create additional "external" complexity that imposes further burdens on taxpayers, practitioners, and administrators. Its practical importance notwithstanding, external complexity has largely been ignored by commentators.

The purpose of this Article is twofold: first, to underscore the need to investigate methods for achieving simplification, and second, to bring a more practical dimension to the reform debate by broadening the perspective from which the U.S. international tax regime is viewed. The move from a national to an international perspective should also foster a more holistic approach to reform, allowing the burdens created by both internal and external complexity to be addressed and, perhaps, remedied. To accomplish

2. U.S. DEP'T OF TREASURY, INTERNATIONAL TAX REFORM: AN INTERIM REPORT 1 (1993), *available at* LEXIS 93 TNI 15-12 [hereinafter TREASURY REPORT ON INTERNATIONAL TAX REFORM]. *See also* 2 STAFF OF JOINT COMM. ON TAXATION, STUDY OF THE OVERALL STATE OF THE FEDERAL TAX SYSTEM AND RECOMMENDATIONS FOR SIMPLIFICATION, PURSUANT TO SECTION 8022(3)(B) OF THE INTERNAL REVENUE CODE OF 1986, at 386 (Comm. Print 2001) [hereinafter JCT SIMPLIFICATION REPORT].

3. Michael J. Graetz, *Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies*, 54 TAX L. REV. 261, 310 (2001).

4. *Id.*

these twin aims, this Article explores the viability of adopting tax coordination—an accepted remedy for external complexity—as a framework within which the U.S. international tax regime might be reformed.

The remainder of this Article is divided into five parts. Part II discusses the terms of the traditional reform debate, further explores the notions of internal and external complexity, and introduces the notion of tax coordination as a potential means of reducing external and internal complexity. Part III refines the concept of tax coordination in an effort to provide a more precise vocabulary for use in the remainder of the Article. Employing this vocabulary, Part IV first elaborates on the theoretical operation of the proposed framework, and then considers the costs and benefits of adopting this approach to reform. Part V examines the manner in which the proposed framework is expected to operate in practice. Because the application of the proposed framework to the task of reforming the entire U.S. international tax regime is beyond the scope of this Article, Part V focuses on a single, concrete example, namely the reform of the Internal Revenue Code provisions governing the deductibility of cross-border charitable contributions. Part VI consists of concluding remarks.

II. BACKGROUND

A. *The Rise and Fall of the 1920s Compromise*

The U.S. international tax regime is rooted in a compromise made during the 1920s concerning the proper division of the jurisdiction to tax income derived from cross-border transactions. By definition, "cross-border" transactions are connected with more than one country. Taxpayers who choose to engage in such transactions risk the possibility that each country that can claim a connection to the transaction will also claim the right to tax the income derived from the transaction. The connections that most commonly form the basis for such claims are the residence of the taxpayer ("residence jurisdiction") and the source of the income derived by the taxpayer ("source jurisdiction").[5] For example, if a U.S. citizen were to perform services in a foreign country, the United States would assert residence jurisdiction as a basis for taxing the income derived from the transaction, while the foreign country might assert source

5. AM. LAW INST., FEDERAL INCOME TAX PROJECT: INTERNATIONAL ASPECTS OF UNITED STATES INCOME TAXATION II: PROPOSALS ON UNITED STATES INCOME TAX TREATIES 5 (1992).

jurisdiction as a basis for taxing the same income because it considers the income as having been derived from within its territory.[6] Thus, absent coordination between residence and source countries, the same income may be subject to tax two, three, or more times. This possibility of double or multiple taxation surely may have "chilling effects on international trade, investment, and commerce."[7]

The high tax rates left in the wake of World War I sharply focused attention on the potentially chilling effects of double taxation and spurred a movement dedicated to its elimination.[8] This movement "gathered considerable momentum"[9] during the 1920s, and eventually led to an international consensus, sometimes referred to as "the 1920s compromise,"[10] regarding the manner in which the jurisdiction to tax should be divided between residence and source countries.[11] The United States has codified the 1920s compromise in its domestic laws governing the taxation of cross-border transactions.[12] The 1920s compromise has also served as the foundation for the United States' extensive network of bilateral income tax treaties.[13]

Over the past seven decades, the U.S. codification of the 1920s compromise has evolved into "an increasingly complex maze of

---

6. *See id.*; Julie Roin, *Rethinking Tax Treaties in a Strategic World with Disparate Tax Systems*, 81 VA. L. REV. 1753, 1759-60 (1995).

7. AM. LAW INST., *supra* note 5, at 5.

8. *See International Double Taxation: Hearing on H.R. 10,165 Before the House Comm. on Ways and Means*, 71st Cong. 4 (1930) (statement of A.W. Mellon, Secretary of the Treasury), *reprinted in* 1 STAFF OF JOINT COMM. ON INTERNAL REVENUE TAXATION, 87TH CONG., LEGISLATIVE HISTORY OF UNITED STATES TAX CONVENTIONS 18 (Comm. Print 1962). For example, in the United States, a normal tax of 1% and an additional graduated surtax of up to 6% were imposed on the net income of individuals beginning in 1913. Revenue Act of 1913, ch. 16, § II(A)(1)-(2), 38 Stat. 166, 166 (1913). By 1918, the normal tax had been increased to a maximum of 8% and the graduated surtax had been increased to a maximum of 65%. Revenue Act of 1918, ch. 18, §§ 210-11(a), 40 Stat. 1057, 1062-64 (1918). These rates were not lowered until 1922. *See* Revenue Act of 1921, ch. 136, § 211(a)(2), 42 Stat. 227, 235-37 (1921).

9. *International Double Taxation: Hearing on H.R. 10,165 Before the House Comm. on Ways and Means*, *supra* note 8, at 18.

10. Graetz, *supra* note 3, at 262.

11. Under this compromise, jurisdiction to tax active business income is accorded to the source country, and jurisdiction to tax passive investment income is accorded to the residence country. Reuven S. Avi-Yonah, *The Structure of International Taxation: A Proposal for Simplification*, 74 TEX. L. REV. 1301, 1306 (1996) [hereinafter Avi-Yonah, *Proposal for Simplification*]; Reuven S. Avi-Yonah, *From Income to Consumption Tax: Some International Implications*, 33 SAN DIEGO L. REV. 1329, 1329-30 (1996). For a historical perspective on the development of the 1920s compromise, see Michael J. Graetz & Michael M. O'Hear, *The "Original Intent" of U.S. International Taxation*, 46 DUKE L.J. 1021, 1094-95 (1997).

12. *See* Avi-Yonah, *Proposal for Simplification*, *supra* note 11, at 1316-28.

13. *See id.* at 1307. For a list of the countries with which the United States currently has income tax treaties in force, see Richard Gordon et al., *Current Status of U.S. Tax Treaties*, 31 TAX MGM'T INT'L J. 114 (2002).

rules."[14] While a certain measure of complexity is a natural concomitant of any developing system of legal rules,[15] the complexity of the current U.S. international tax rules cannot be attributed solely to their maturation and closer reflection of economic realities.[16] Some commentators have attributed the rules' excess complexity to the multitude of conflicting considerations that must be taken into account when formulating international tax policy.[17] Other commentators have attributed their excess complexity to "the trend in the international tax area to enact provisions based on isolated policy considerations without an integrated approach."[18] This ad hoc approach is evident in the Internal Revenue Code's foreign tax credit provisions and in the series of regimes enacted by Congress to combat the abusive deferral of taxation through the use of foreign corporations.[19] Although Congress may have intended to "make an

---

14. Karen V. Kole, *The Status of United States International Taxation: Another Fine Mess We've Gotten Ourselves into*, 9 NW. J. INT'L L. & BUS. 49, 49 (1988).

15. *See* THE FEDERALIST NO. 78, at 529 (Alexander Hamilton) (Jacob E. Cooke ed., 1961).

> It has been frequently remarked with great propriety, that a voluminous code of laws is one of the inconveniences necessarily connected with the advantages of a free government. To avoid an arbitrary discretion in the courts, it is indispensable that they should be bound down by strict rules and precedents, which serve to define and point out their duty in every particular case that comes before them; and it will readily be conceived from the variety of controversies which grow out of the folly and wickedness of mankind, that the records of those precedents must unavoidably swell to a very considerable bulk, and must demand long and laborious study to acquire a competent knowledge of them.

Id.

16. *See, e.g.*, Daniel N. Shaviro, *Does More Sophisticated Mean Better? A Critique of Alternative Approaches to Sourcing the Interest Expense of U.S. Multinationals*, 54 TAX L. REV. 353, 353-55 (2001).

17. TREASURY REPORT ON INTERNATIONAL TAX REFORM, *supra* note 2, at vi; Stanford G. Ross, *A Perspective on International Tax Policy*, LEXIS 85 TNI 3-4 (1985) ("What accounts for the extraordinary complexity of international tax policy? Part of the answer is that there are not only a host of sometimes conflicting policy considerations to balance in resolving almost every issue, but there generally are a host of competing viewpoints as to each policy consideration that is considered relevant.").

18. Kole, *supra* note 14, at 54. *See also* GARY CLYDE HUFBAUER, U.S. TAXATION OF INTERNATIONAL INCOME: BLUEPRINT FOR REFORM 47 (1992) ("The complexity of the present US law reflects no new architecture, but rather an extensive patchwork designed to repair a succession of leaks."); James S. Eustice, *Commentary*, 9 AM. J. TAX POL'Y 101, 102 (1991) ("The United States has exercised undeniable leadership, if that is the word, in drafting complex, microregulatory, anti-abuse driven statutory provisions in the international tax area that are second to none . . . ."); Graetz, *supra* note 3, at 263.

19. *See* Kole, *supra* note 14, at 59 ("Ad hoc legislative adjustment may be leading to a more theoretically perfect foreign tax credit mechanism. Unfortunately, this 'perfect' mechanism may be impossible for either the taxpayer or the Service to administer. At what price victory?"); John McDonald, *Anti-Deferral Deferred: A*

inherently imperfect system perfect" when it enacted each of the individual provisions in these areas, when one considers these provisions as a whole, it becomes clear that they have resulted in the imposition of "monumental administrative burdens" on taxpayers, practitioners, and administrators.[20]

Of late, a growing chorus of voices has been calling for the wholesale reform and restructuring of the U.S. international tax regime.[21] These calls for reform have been prompted not only by the onerous complexity of the U.S. international tax regime,[22] but also by

---

Proposal for the Reform of International Tax Law, 16 NW. J. INT'L L. & BUS. 248, 251 (1995) ("The trend has been for Congress to make each successive anti-deferral regime more aggressive in limiting deferral opportunities .... Unfortunately, however, these regimes were each developed to prevent a particular type of deferral which Congress thought was abusive. They were not developed to promote one overarching tax goal. As a result, they overlap and cause considerable confusion."). *See infra* Part III.B.2. for a more detailed description of the manner in which foreign corporations may be employed to obtain deferral of taxation.

20. Kole, *supra* note 14, at 49.

21. *See, e.g.*, Avi-Yonah, *Proposal for Simplification*, *supra* note 11, at 1303-05; Graetz, *supra* note 3, at 269; Graetz & O'Hear, *supra* note 11, at 1024-26; Robert A. Green, *The Future of Source-Based Taxation of the Income of Multinational Enterprises*, 79 CORNELL L. REV. 18 (1993); Charles E. McLure, Jr., *Substituting Consumption-Based Direct Taxation for Income Taxes as the International Norm*, 45 NAT'L TAX J. 145 (1992); John S. Nolan, *United States Taxation of Foreign Investment in the United States*, 8 AM. J. TAX POL'Y 291 (1990); Robert J. Peroni, *Back to the Future: A Path to Progressive Reform of the U.S. International Income Tax Rules*, 51 U. MIAMI L. REV. 975, 975-76 (1997); Walter D. Schwidetzky, *Subpart F, 1986 and Beyond*, 17 U. BALT. L. REV. 213, 247-48 (1988); SECTION OF TAXATION, N.Y. STATE BAR ASS'N, REPORT ON PROPOSALS FOR GUIDANCE WITH RESPECT TO PASSIVE FOREIGN INVESTMENT COMPANIES (2001), *available at* LEXIS 2001 WTD 109-41; David R. Tillinghast, *International Tax Simplification*, 8 AM. J. TAX POL'Y 187 (1990); Alvin C. Warren, Jr., *Alternatives for International Corporate Tax Reform*, 49 TAX L. REV. 599, 607-12 (1994).

There has been an independent debate over whether existing international tax norms may be adapted to the evolving area of electronic commerce or whether a new set of norms must be developed. *See, e.g.*, OFFICE OF TAX POLICY, U.S. DEP'T OF TREASURY, SELECTED TAX POLICY IMPLICATIONS OF GLOBAL ELECTRONIC COMMERCE (1996); COMM. ON FISCAL AFFAIRS, ORG. FOR ECON. CO-OPERATION & DEV., CLARIFICATION ON THE APPLICATION OF THE PERMANENT ESTABLISHMENT DEFINITION IN E-COMMERCE: CHANGES TO THE COMMENTARY ON THE MODEL TAX CONVENTION ON ARTICLE 5 (2000); COMM. ON FISCAL AFFAIRS, ORG. FOR ECON. CO-OPERATION & DEV., ELECTRONIC COMMERCE: TAXATION FRAMEWORK CONDITIONS (1998); COMM. ON FISCAL AFFAIRS, ORG. FOR ECON. CO-OPERATION & DEV., TAX TREATY CHARACTERISATION ISSUES ARISING FROM E-COMMERCE (2001), *available at* http://www.tax-news.com/asp/res/Treatychar_finalrep.pdf; Reuven S. Avi-Yonah, *International Taxation of Electronic Commerce*, 52 TAX L. REV. 507, 531-51 (1997); Arthur J. Cockfield, *Balancing National Interests in the Taxation of Electronic Commerce Business Profits*, 74 TUL. L. REV. 133, 138-39 (1999); Stanley I. Katz, *International Taxation of Electronic Commerce: Evolution Not Revolution*, 52 TAX L. REV. 655 (1997); David R. Tillinghast, *Taxation of Electronic Commerce: Federal Income Tax Issues in the Establishment of a Software Operation in a Tax Haven*, 4 FLA. TAX REV. 339, 341-42 (1999).

22. *See* Kole, *supra* note 14, at 50 ("[T]he United States international tax law is currently unmanageable, unwieldy, and, at best, an area fraught with many unnecessary complexities."); Sheldon D. Pollack, *Tax Complexity, Reform, and the*

a questioning of the continued viability of the 1920s compromise upon which the regime was built.[23] Increasing globalization,[24] which has both accentuated the complexity of the U.S. international tax regime and, according to some, rendered the 1920s compromise obsolete, has only added to the urgency of these calls.[25]

B. *The Traditional Debate over Reform*

The ensuing debate over how to reform the ailing U.S. international tax regime has largely been shaped by the traditional concerns of efficiency, fairness, and simplicity.[26] Each of these

---

Illusions of Tax Simplification, 2 GEO. MASON INDEP. L. REV. 319, 336 (1994) ("There is little doubt that in international taxation, tax complexity caught up to international business practices with a vengeance of its own."); *supra* note 2 and accompanying text. *See also* HUFBAUER, *supra* note 18, at 47 ("Beginning with the Revenue Act of 1962, the US system of taxing international income has grown enormously complex." (footnote omitted)).

23. Avi-Yonah, *Proposal for Simplification*, *supra* note 11, at 1303-04 (referring to the 1920s compromise as a "flawed miracle"); Thomas F. Field, *International Tax Policy Conference in New York Focuses on "Flawed Miracle,"* LEXIS 2000 WTD 221-3 (Nov. 12, 2000); Roin, *supra* note 6, at 1754 (calling for a re-evaluation of the 1920s compromise in light of (i) our treaty partners' integration of corporate and shareholder taxation and (ii) the decrease in U.S. corporate income tax rates); Alvin C. Warren, Jr., *Income Tax Discrimination Against International Commerce*, 54 TAX L. REV. 131, 168-69 (2001) ("[T]he time has come for a fundamental reexamination of the international income tax system, along the lines undertaken by the League of Nations more than 70 years ago. Subsequent developments, including the GATT and WTO, as well as corporate tax integration, threaten to render the old regime obsolete, if it is not already so.").

24. "Globalization" is an ambiguous term, the meaning of which often depends on the writer who employs it. *See* Maxwell O. Chibundu, *Globalizing the Rule of Law: Some Thoughts at and on the Periphery*, 7 IND. J. GLOBAL LEGAL STUD. 79, 80 (1999) ("Much has been written about globalization . . . . Yet, if any sense is to be made of the vast literature that this highly ambiguous term is generating, the reader deserves some kind of reference point from the vantage of the writer."). *See also* Gordon R. Walker & Mark A. Fox, *Globalization: An Analytical Framework*, 3 IND. J. GLOBAL LEGAL STUD. 375, 380 (1996) ("globalization means 'different things in different contexts;' it is a portmanteau word" (footnote omitted)); Adelle Blackett, *Globalization and Its Ambiguities: Implications for Law School Curricular Reform*, 37 COLUM. J. TRANSNAT'L L. 57, 60-66 (1998) ("At the heart of the ambiguity of globalization lies one simple question: "What is it?"). Here, the term globalization is used to "describe[ ] the growing irrelevance of borders in international financial transactions." Walker & Fox, *supra*, at 380.

25. *See* Avi-Yonah, *Proposal for Simplification*, *supra* note 11, at 1304.

26. Michael J. Graetz, *Paint-by-Numbers Tax Lawmaking*, 95 COLUM. L. REV. 609, 609 (1995) ("Although their meaning and contours have long been controversial, the general criteria for evaluating changes in tax law enjoy both stability and consensus. At least since Adam Smith, there has been virtually universal agreement that the nation's tax law should be fair, economically efficient, and simple to comply with and to administer."). *See also* OFFICE OF TAX POLICY, DEP'T OF TREASURY, THE DEFERRAL OF INCOME EARNED THROUGH U.S. CONTROLLED FOREIGN CORPORATIONS: A POLICY STUDY 82 (2000) [hereinafter TREASURY REPORT ON SUBPART F]; STAFF OF

concerns is described more fully below because an understanding of the traditional terms of the reform debate is a prerequisite to understanding why simplification has proved such an elusive goal. These concerns will be discussed in descending order of the importance that has been accorded to them by commentators participating in the reform debate.

Of the three traditional concerns, efficiency has by far dominated the reform debate.[27] A tax system is considered "efficient" if it promotes economic welfare by allowing "resource allocation decisions [to be] based solely on which investments are expected to be the most productive."[28] Discussions of a tax system's efficiency are normally cast in terms of its "neutrality."[29] Three competing doctrines of neutrality exist: capital export neutrality, capital import neutrality, and national neutrality.[30]

Capital export neutrality seeks to eliminate distortions in a taxpayer's investment decisions by taxing her at the same (domestic) rate no matter where she invests—whether at home or abroad.[31] The U.S. foreign tax credit is an example of a modified form of capital export neutrality.[32] Capital import neutrality seeks to eliminate

---

JOINT COMM. ON TAXATION, PUB. NO. JCX-13-99, OVERVIEW OF PRESENT-LAW RULES AND ECONOMIC ISSUES IN INTERNATIONAL TAXATION 38 (1999) [hereinafter JCT REPORT].

27. Graetz, *supra* note 3, at 269-77. *See also* J. Clifton Fleming, Jr. et al., *Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income*, 5 FLA. TAX REV. 299, 302 (2001).

> [O]ne would expect tax policy analysts to routinely examine the equity implications of international income tax rules by applying the fairness criterion with the same rigor as in the domestic context. But surprisingly, there has been relatively little discussion in the literature regarding the role of the ability-to-pay concept in analyzing international tax policy issues.

Id.

28. TREASURY REPORT ON SUBPART F, *supra* note 26, at 84. *See also* Terrence R. Chorvat, *Taxing International Corporate Income Efficiently*, 53 TAX L. REV. 225, 228 (2000); Peroni, *supra* note 21, at 983; H. David Rosenbloom, *From the Bottom up: Taxing the Income of Foreign Controlled Corporations*, 26 BROOK. J. INT'L L. 1525, 1526-27 (2001); Eric M. Zolt, *The Uneasy Case for Uniform Taxation*, 16 VA. TAX REV. 39, 43 (1996).

29. JCT REPORT, *supra* note 26, at 38. *See also* TREASURY REPORT ON INTERNATIONAL TAX REFORM, *supra* note 2, at 2; Robert L. Palmer, *Toward Unilateral Coherence in Determining Jurisdiction to Tax Income*, 30 HARV. INT'L L.J. 1, 11-12 (1989).

30. JCT REPORT, *supra* note 26, at 47-50; HUFBAUER, *supra* note 18, at 48-49.

31. JCT REPORT, *supra* note 26, at 3-4; HUFBAUER, *supra* note 18, at 49-55.

32. "Pure" capital export neutrality would not only require a taxpayer to pay the United States the difference between her U.S. and foreign tax liability when the foreign tax is *lower* than the U.S. tax, but would also require the United States to refund to the taxpayer the difference between her U.S. and foreign tax liability when the foreign tax is *higher* than the U.S. tax. Julie A. Roin, *The Grand Illusion: A Neutral System for the Taxation of International Transactions*, 75 VA. L. REV. 919, 923-30 (1989). A refund of the difference between a higher foreign tax and a lower U.S. tax

competitive distortions by taxing all investments in the same country at the same rate, regardless of the taxpayer's residence.[33] A territorial tax system, meaning one that exempts foreign source income from tax, is an example of capital import neutrality.[34] National neutrality seeks to ensure that a country's tax revenue is the same whether its residents make investments at home or abroad.[35] Allowing a deduction rather than a credit for foreign taxes paid is an example of national neutrality.[36] These doctrines are described as "competing" because it is not possible to implement all of them simultaneously.[37] Moreover, changes in the world economy have led some commentators to question the continuing relevance of these doctrines to the task of formulating international tax policy.[38]

In terms of importance, fairness usually follows efficiency. A tax system is considered "fair" if the tax burden is justly distributed between taxpayers.[39] Discussions of a tax system's fairness are usually cast in terms of "equity." In the domestic context, the following two types of equity are normally considered: horizontal and vertical equity.[40] Horizontal equity requires that "similarly situated taxpayers should be treated similarly under the tax laws."[41] Vertical equity "exists when the tax distinguishes appropriately between taxpayers who are not equals—when the distribution of the tax burden reflects the correct degree of progressivity, proportionality, or

---

would, however, "allow[ ] source countries to exploit the United States . . . [because] a source country could raise its taxes on income earned by U.S. investors with impunity." *Id.* at 928. To prevent the subsidization of countries with higher tax rates, the United States limits the foreign tax credit to the amount of U.S. tax on the taxpayer's foreign source income. *See* I.R.C. § 904 (2001). For this reason, the U.S. foreign tax credit has been described as a form of "defensive" capital export neutrality. Roin, *supra*, at 929.

33. JCT REPORT, *supra* note 26, at 4; HUFBAUER, *supra* note 18, at 57-60.

34. Graetz & O'Hear, *supra* note 11, at 1063-64 (citing France, Germany, the Netherlands, and Canada as examples of countries that have adopted a territorial system of taxation).

35. JCT REPORT, *supra* note 26, at 47-48; HUFBAUER, *supra* note 18, at 55-57. National neutrality has been derided as not being a form of "neutrality" at all, but rather a means of promoting domestic economic growth by creating a disincentive to foreign investment. HUFBAUER, *supra* note 18, at 57; Graetz & O'Hear, *supra* note 11, at 1041-43.

36. Graetz & O'Hear, *supra* note 11, at 1041; Tsilly Dagan, *National Interests in the International Tax Game*, 18 VA. TAX REV. 363, 366-67 (1998).

37. JCT REPORT, *supra* note 26, at 50; Graetz & O'Hear, *supra* note 11, at 1108.

38. *See* HUFBAUER, *supra* note 18, at 60-61; Daniel J. Frisch, *The Economics of International Tax Policy: Some Old and New Approaches*, 47 TAX NOTES 581, 586-89 (1990). *But cf.* John P. Steines, *Income Tax Implications of Free Trade*, 49 TAX L. REV. 675, 685-87 (1994).

39. Nancy H. Kaufman, *Fairness and the Taxation of International Income*, 29 LAW & POL'Y INT'L BUS. 145, 157 (1998).

40. *Id.* at 164. *See also* Zolt, *supra* note 28, at 87.

41. Palmer, *supra* note 29, at 10.

regressivity."[42] In the United States, progressivity has traditionally been the "appropriate" distinction between taxpayers who are not equals, and, hence, a goal of our tax system has been to ensure that the "rate of tax imposed on those with larger incomes should be higher than that imposed on those with smaller incomes."[43]

In spite of being easily defined, horizontal and vertical equity have proved difficult to apply. In the case of horizontal equity, there has been a great deal of discussion about the traits that should be taken into account in determining whether taxpayers are similarly situated. In the case of vertical equity, the discussion has centered on the standards that should be used in determining the differing amounts that taxpayers who are not similarly situated should be required to pay.[44] Scholars have also debated the question whether horizontal and vertical equity have any independent normative content,[45] leading some to contend that these concepts should be abandoned because they do not "add anything to the need to analyze tax changes in terms of basic tax policy objectives and indeed may conceal problems or lead policymakers astray as particular tax changes are considered."[46]

In the international context, a third type of equity has surfaced—inter-nation equity. The concept of inter-nation equity,

---

42. Kaufman, *supra* note 39, at 164.

43. Palmer, *supra* note 29, at 10.

44. Graetz, *supra* note 26, at 610. Adding foreign taxpayers to the equation only further complicates the application of these concepts. *See* Kaufman, *supra* note 39, at 167. For example, consider the horizontal equity implications of the U.S. foreign tax credit. Because the United States has chosen to adopt a "defensive" form of capital export neutrality, two domestic taxpayers with equal worldwide incomes may pay radically different amounts of tax depending on the source of their income (i.e., whether the income is derived from the United States, a low-tax foreign jurisdiction, a high-tax foreign jurisdiction, or some combination of the three). *See supra* note 32. The only means of achieving horizontal equity for foreign tax credit purposes would be for the United States to adopt "pure" capital export neutrality and, in effect, subsidize the fiscs of other countries. *Id.* Consider also the vertical equity (i.e., progressivity) implications raised by the taxation of *all* foreign persons at the same flat rate on their U.S. source investment income, regardless of differences in their worldwide income (or even of differences in their total U.S. source income). *See* I.R.C. §§ 871, 881, 1441, 1442 (2001).

45. *See* Louis Kaplow, *Horizontal Equity: Measures in Search of a Principle*, 42 NAT'L TAX J. 139 (1989); Richard A. Musgrave, *Horizontal Equity, Once More*, 43 NAT'L TAX J. 113 (1990); Louis Kaplow, *A Note on Horizontal Equity*, 1 FLA. TAX REV. 191 (1992); Richard A. Musgrave, *Horizontal Equity: A Further Note*, 1 FLA. TAX REV. 354 (1993); Paul R. McDaniel & James R. Repetti, *Horizontal and Vertical Equity: The Musgrave/Kaplow Exchange*, 1 FLA. TAX REV. 607 (1993).

46. McDaniel & Repetti, *supra* note 45, at 622. *See also* Peter Westen, *The Empty Idea of Equality*, 95 HARV. L. REV. 537, 547 (1982) ("Equality is an empty vessel with no substantive moral content of its own. Without moral standards, equality remains meaningless, a formula that can have nothing to say about how we should act. With such standards, equality becomes superfluous, a formula that can do nothing but repeat what we already know." (footnote omitted)).

which was developed by Professor Peggy Musgrave, "relates to the distribution of the competence to tax among countries, not to the relative amounts of tax paid by individual taxpayers to their governments."[47] Although inter-nation equity has been advanced as a more appropriate measure of fairness in the international context,[48] it appears to suffer from the same defects as horizontal and vertical equity (i.e., difficulty of application and lack of normative content).[49]

In terms of importance, simplicity is the third and last of the traditional concerns that have shaped the reform debate. A tax system is considered "simple" if its rules are easily understood by taxpayers and capable of efficient implementation by tax administrators.[50] Because of its perennial inclusion in the triumvirate of concerns that guide the assessment of tax systems, commentators often acknowledge the importance of simplicity as a tax policy goal. Nevertheless, these same commentators almost as often fail to address the need for simplification when they reach the point of engaging in substantive discussions of tax policy.[51] Even when commentators have seriously discussed means for achieving simplification, their focus has been on the "internal" complexity of the U.S. international tax regime. In other words, they have viewed the regime as a closed system, considering only methods of reducing the complexity of individual U.S. rules or of the interaction of one U.S. rule with another U.S. rule. By taking such a parochial view of the problem, commentators have unnecessarily constrained their ability effectively to address the need for simplification.

The path to any form of simplification is straightforward: first, the sources of complexity must be identified, and then, appropriate steps must be taken to eliminate or, at the very least, mitigate them. Thus far, no difficulty has been encountered in identifying the sources of the internal complexity of the U.S. international tax regime. As mentioned above, commentators have attributed the regime's internal complexity to a number of sources, including (i) its closer reflection of economic realities, (ii) the multitude of conflicting considerations that must be taken into account when formulating international tax policy, and (iii) the failure of Congress to take an integrated approach to formulating international tax policy.[52]

While the sources of internal complexity can be identified with relative ease, eliminating or mitigating them proves a more difficult

---

47. Kaufman, *supra* note 39, at 153.

48. *Id.* at 153-54.

49. *See id.* at 188-94.

50. *See* TREASURY REPORT ON INTERNATIONAL TAX REFORM, *supra* note 2, at 1; Palmer, *supra* note 29, at 12.

51. *See supra* note 3 and accompanying text.

52. *See supra* text accompanying notes 14-20.

task. Efforts to address the first two sources of internal complexity have been hampered by the fact that they are largely immitigable—the first because it is an unavoidable by-product of the maturation of the U.S. international tax rules, and the second because it is an unavoidable concomitant of the domestic legislative process. The mitigability of the third source of complexity (i.e., the failure of Congress to take an integrated approach to formulating international tax policy) is severely limited by its close relationship with the second source of complexity (i.e., the multitude of conflicting considerations that must be taken into account when formulating tax policy). At a superficial level, the third source of complexity could be mitigated by eliminating redundancy in the U.S. international tax regime[53] and by promoting better coordination among its provisions.[54] Nonetheless, a truly integrated approach to formulating international tax policy would require more than just a lapidary style of legislative drafting. It would also require that a consistent policy framework be devised in order to ensure that the various U.S. international tax rules do not work at cross-purposes.

To develop a consistent policy framework within the confines of the traditional reform debate, Congress would have to squarely address both efficiency and fairness concerns. As suggested by the discussion above, however, addressing these concerns is much more difficult than articulating them. This difficulty stems, in part, from the fact that these concerns are mutable: there is (i) no universally-accepted theory of neutrality, (ii) no consensus concerning the traits to be taken into account when determining who is similarly situated for purposes of measuring horizontal equity, and (iii) no consensus concerning the standards to be applied in determining the differing contributions of taxpayers who are not similarly situated for purposes of measuring vertical equity. This difficulty also stems from the fact that a tax system cannot be perfectly efficient and fair, and, at the same time, simple enough for taxpayers to follow and revenue personnel to administer. Rather, a balance must be struck between

---

53. For example, are six separate regimes (viz., personal holding company, foreign personal holding company, controlled foreign corporation, foreign investment company, passive foreign investment company, and accumulated earnings tax) really necessary to curtail the abusive deferral of taxation through the use of foreign corporations? *See* 2 JCT SIMPLIFICATION REPORT, *supra* note 2, at 411-18 (advocating the elimination of the foreign personal holding company and foreign investment company regimes and the exclusion of foreign corporations from the application of the personal holding company rules); Robert J. Peroni et al., *Getting Serious About Curtailing Deferral of U.S. Tax on Foreign Source Income*, 52 SMU L. REV. 455, 512-14 (1999) (advocating the adoption of a single "pass-through" regime in place of the six existing regimes).

54. For example, is it really necessary to employ several different definitions of the term "resident"? *Compare* I.R.C. § 865(g) (2001) (income tax), *and* I.R.C. § 7701(b) (2001) (income tax), *with* Treas. Reg. § 20.0-1(b)(1) (2001) (estate tax), *and* Treas. Reg. § 25.2501-1(b) (2001) (gift tax).

efficiency, fairness, and simplicity because "[c]onflict among these concerns is inevitable."[55]

Compounding the difficulty inherent in developing a consistent policy framework is the fact that international tax policy-making involves much more than just a balancing of efficiency and fairness concerns. The traditional focus on these concerns may stem from the fact that they lend themselves to the theoretical analysis preferred by commentators. On a more practical level, however, U.S. international tax policy must also take into account a number of other concerns, including the expected impact of tax provisions on (i) the competitiveness of U.S. multinationals,[56] (ii) political relations with foreign countries,[57] (iii) the need to raise revenue,[58] (iv) the fostering of economic growth,[59] and (v) the prevention of tax avoidance and evasion.[60]

Thus, to devise a consistent policy framework that would enable real strides to be made toward the mitigation of the third source of complexity, policymakers would have to address each of these separate considerations, reconcile them to the extent that they conflict, and ultimately, conflate them into a unified whole. The sheer number of these separate considerations—and the number of competing viewpoints that they often mask—render this task impracticable, if not impossible. It is no wonder, then, that "simplicity has proven . . . to be an elusive goal" in tax policy-making,[61] and that it has been called the "forgotten stepchild of income tax policy."[62]

C. *A Shift in Perspective*

The parochial view of complexity embraced by commentators does not, however, comport with reality. Experienced taxpayers, practitioners, and administrators recognize that the U.S.

---

55. Graetz, *supra* note 26, at 610. *See also* Fleming et al., *supra* note 27, at 330-31, 350; Rosenbloom, *supra* note 28, at 1528-29 ("[N]ot only are efficiency, equity, and simplicity all abstract concepts subject to considerable doubt and interpretation when applied in the evaluation of specific provisions, but the factors actually conflict with one another when any of them is pursued with a single mind.").

56. TREASURY REPORT ON SUBPART F, *supra* note 26, at 82, 86; TREASURY REPORT ON INTERNATIONAL TAX REFORM, *supra* note 2, at 2.

57. Palmer, *supra* note 29, at 20-21.

58. *See* Dagan, *supra* note 36, at 387-88. *Cf.* Nolan, *supra* note 21, at 324.

59. JCT REPORT, *supra* note 26; at 38.

60. TREASURY REPORT ON INTERNATIONAL TAX REFORM, *supra* note 2, at 1-2; Kole, *supra* note 14, at 51-52.

61. TREASURY REPORT ON INTERNATIONAL TAX REFORM, *supra* note 2, at 1. *See also* Graetz, *supra* note 26, at 610 ("The pursuit of simplicity is frequently a bystander.").

62. Graetz, *supra* note 3, at 310.

international tax regime applies only to *cross-border* movements of capital and labor—movements that involve one or more other countries and that will almost invariably implicate those countries' international tax regimes.[63] As sovereign states, these countries are able to devise their own international tax rules, which are free to conflict with those of the United States (as well as with those of other countries). Globalization has only served to ensure that this potential for conflict is realized with increasing frequency.

Conflicts between international tax regimes foment complexity that may impede the free flow of international commerce. Consider, for example, the situation faced by a U.S. corporation that, to date, has performed its services only domestically, but is considering a request for technical and administrative assistance from a Costa Rican enterprise. Assume for purposes of this example that, should the project be undertaken, all services will be performed in the United States, the gross amount to be charged for the services is USD 150,000,[64] and the net income expected to be received from rendering the services is USD 60,000.[65] Since this project has contacts with both the United States and Costa Rica, it will implicate both countries' international tax regimes.

Under its international tax rules, Costa Rica subjects nonresidents to income tax on their Costa Rican source income.[66] For this purpose, Costa Rican source income is defined to include payments made for technical, financial, or administrative assistance rendered from abroad to Costa Rican domiciliaries.[67] Because Costa Rica sources the income from performing these particular services to the place where the services are used, the U.S. corporation in this example will be subject to tax in Costa Rica on the income derived from the Costa Rican project even though none of the services is actually performed in Costa Rica. Costa Rica imposes a gross-basis

---

63. *See generally* 1 JCT SIMPLIFICATION REPORT, *supra* note 2, at 93-97.

64. Please note that the three-letter alphabetic codes developed by the International Organization for Standardization are used in this Article to designate the currency in which a monetary amount is expressed. *See* INT'L ORG. FOR STANDARDIZATION, ISO NO. 4217, CODES FOR THE REPRESENTATION OF CURRENCIES AND FUNDS (6th ed. 2001).

65. These figures were arbitrarily chosen simply for purposes of illustration. The "net income" figure is intended to take into account all allowable U.S. federal income tax deductions that are either directly or indirectly allocable to the performance of the services for the Costa Rican enterprise—including the deduction for foreign taxes paid, which is available under I.R.C. § 164 (because the U.S. corporation is unable to avail itself of the benefits of the foreign tax credit) and will alleviate the burdens of double taxation to a limited extent. For the sake of simplicity, it will be assumed that the Costa Rican enterprise contracted to pay to the U.S. corporation in U.S. currency a specified amount that was denominated in U.S. currency.

66. Income Tax Law, Law No. 7092, Apr. 21, 1988, arts. 52-53 (Costa Rica).

67. *Id.* art. 55(h).

withholding tax on such income at a rate of twenty-five percent.[68] The Costa Rican tax on the payment for the services rendered by the U.S. corporation will, therefore, be USD 37,500 (25% x USD 150,000) and the net payment made to the U.S. corporation will be USD 112,500 (USD 150,000 - USD 37,500).

Under its international tax rules, the United States subjects domestic corporations to income tax on their worldwide income (i.e., regardless of its source).[69] Nonetheless, in an effort to alleviate the burden of double taxation, the United States permits domestic corporations to claim a credit for foreign taxes paid on their *foreign source* income.[70] For purposes of determining the amount of the foreign tax credit, income from the performance of services is sourced to the place where the services are performed,[71] which, in the instant example, is the United States. Thus, although the U.S. corporation in this example has paid foreign (i.e., Costa Rican) taxes on a portion of its worldwide income, it will *not* be entitled to claim those taxes as a credit against its U.S. federal income tax liability because the United States considers the corporation as having paid those taxes with respect to *U.S. source* income. Assuming that the highest marginal corporate income tax rate will apply, the U.S. corporation will be required to pay USD 21,000 (35% x USD 60,000) in tax to the United States on the net income from performing these services.

Because the United States and Costa Rica have adopted conflicting rules for sourcing income from the performance of services, the U.S. corporation in this example will be required to pay tax twice on the same income.[72] The total tax on this transaction will be USD 58,500 (USD 37,500 + USD 21,000) leaving an after-tax profit of only USD 1,500. Assuming the U.S. corporation is well advised, it will have to decide in advance whether the burden imposed by double taxation renders the project economically unfeasible. This example concretely demonstrates how conflicts between international tax regimes can create complexity that may render cross-border movements of capital and labor more difficult, or even impossible as a practical matter.

---

68. *Id.* arts. 58-59.

69. I.R.C. § 11 (2001) ("A tax is hereby imposed for each taxable year on the taxable income of every corporation."); Treas. Reg. § 1.11-1(a) (2001) (for purposes of I.R.C. § 11, "[i]t is immaterial that a domestic corporation . . . may derive no income from sources within the United States"). A "domestic" corporation is one that is "created or organized in the United States or under the law of the United States or of any State." I.R.C. § 7701(a)(4) (2001).

70. I.R.C. §§ 901, 904 (2001).

71. I.R.C. §§ 861(a)(3), 862(a)(3) (2001).

72. There is no income tax treaty between the United States and Costa Rica that might coordinate these conflicting source rules. *See* Gordon et al., *supra* note 13.

Contrasting this international perspective with the more traditional national perspective, one might refer to the complexity created by the conflicts between international tax regimes as "external" complexity. The United States has made an effort to mitigate the external complexity of its international tax regime by taking steps to coordinate its international tax rules with those of other countries. Most notably, the United States has entered into a broad network of bilateral income tax treaties that attempt to coordinate the international tax rules of the United States with those of each of its treaty partners:

> Double taxation agreements (tax treaties) are an essential element in facilitating economic relations between States and encouraging flows of capital and labor. They form a firm and reliable basis for tax relations between States. They limit and regulate the taxing jurisdiction of the States entering into them so as to ensure the orderly application of the domestic tax laws of what are often quite different systems. Their importance is underlined by the large numbers that are currently in force and the fact that international organizations and the business community repeatedly recommend the enlargement and improvement of the treaty network.[73]

Despite playing an important role in mitigating external complexity,[74] bilateral income tax treaties have by no means eliminated the problem. First, tax treaties are effective only between the contracting states. Though broad, the U.S. network of income tax treaties is not comprehensive; indeed, it embraces less than one-third of the countries in the world.[75] Second, revising and extending the tax treaty network can only be accomplished by undertaking a "slow and arduous" negotiating process with each current or potential treaty partner.[76] Third, the tax treaties that do exist are not

---

73. COMM. ON FISCAL AFFAIRS, ORG. FOR ECON. CO-OPERATION & DEV., TAX TREATY OVERRIDES ¶ 1 (1990) (footnote omitted), *available at* LEXIS 90 TNI 7-13. *See also Tax Treaties: Hearing on Various Tax Treaties Before the S. Comm. on Foreign Relations*, 97th Cong. 7-8 (1982) (statement of John E. Chapoton, Assistant Secretary of the Treasury, Tax Policy) ("Among the major impediments to free capital and technology flows are the rules of national tax systems and their interaction with the systems of other countries. Tax treaties seek to eliminate, or at least mitigate, the impact of these impediments.").

74. *See infra* text accompanying notes 116-27.

75. At present, the United States has income tax treaties in force with more than sixty countries. *See* Gordon et al., *supra* note 13, at 114. There are approximately 190 countries in the world. BUREAU OF INTELLIGENCE AND RESEARCH, U.S. DEP'T OF STATE, FACT SHEET: INDEPENDENT STATES IN THE WORLD (2001), *at* http://www.state.gov/s/inr/rls/4250.htm (last visited Feb. 7, 2002). *See* Fleming et al., *supra* note 27, at 339 ("Moreover, the United States does not have bilateral tax treaties with most of the world's nations. Thus, the United States must adopt a unilateral measure to mitigate double taxation of its residents' international income when a treaty does not apply.").

76. AM. LAW INST., *supra* note 5, at 12.

intended to be exhaustive attempts at coordination.[77] Fourth, the United States inserts a "saving clause" into each of its income tax treaties, which severely limits the extent to which those treaties can alter the U.S. federal income taxation of U.S. persons with cross-border activities.[78] Finally, the coordination that is achieved through tax treaties is routinely undermined by Congress through the passage of legislation that is intended to override inconsistent treaty provisions.[79]

Viewing the problem of complexity from a more realistic international perspective and acknowledging the shortcomings of negotiated efforts at tax coordination, the remainder of this Article explores the viability of adopting tax coordination as a framework within which the U.S. international tax regime might be reformed. In theory, by pursuing coordination at both the national and international levels—through both the domestic legislative process and treaty-making—the United States should more effectively be able to alleviate the burdens imposed by external complexity. In practice, by adopting a more holistic approach to the problem, the United States may also be able to reduce the internal complexity of its international tax regime. The application below[80] of the proposed framework to the Internal Revenue Code provisions governing the deductibility of charitable contributions demonstrates the proposed framework's potential to serve as a restraint on the multitude of conflicting considerations that must be taken into account when formulating U.S. international tax policy. By restraining these conflicting considerations, the proposed framework may open the way to the development of a more internally consistent policy framework and, in turn, to a measure of internal simplification.[81]

III. REFINING THE RELEVANT CONCEPTS

Because the legal academic literature has overwhelmingly focused on the internal complexity of the U.S. international tax

---

77. *See* Lee Burns, *Commentary*, 53 TAX L. REV. 39, 43 (1999).

78. Subject to enumerated exceptions, the saving clause reserves to the United States the right to tax its citizens and residents as if the treaty had never entered into force. *See, e.g.*, UNITED STATES MODEL INCOME TAX CONVENTION, art. 1, para. 4 (1996), *reprinted in* 1 Tax Treaties (CCH) ¶ 214.01 (1998).

79. *See* Anthony C. Infanti, *Curtailing Tax Treaty Overrides: A Call to Action*, 62 U. PITT. L. REV. 677, 681-83 (2001).

80. *See infra* Part V.E.

81. This notion that complexity may be reduced through the adoption of a framework within which legislative changes must be made is consistent with the view taken by some that simplification is not "a tax policy goal at all," but rather "an effective limitation" on competing policy concerns. Palmer, *supra* note 29, at 12.

regime, tax coordination (and the related concept of tax harmonization) has received scant attention as an independent means of guiding the formation of U.S. international tax policy.[82] Most of the discussions of tax coordination (and tax harmonization) that can be found in the legal academic literature occur in the context of assessing the impact on the United States of regional economic arrangements such as the North American Free Trade Area and the European Union.[83] Nevertheless, whether they occur in the context of the reform debate or of considering the impact of regional economic arrangements, these discussions have generally been marked by a failure precisely to define the concepts of tax coordination and tax harmonization.[84] Due to the lack of precision in defining these concepts, it is necessary to give some content to the terms "tax coordination" and "tax harmonization" before proceeding to explore the viability of adopting tax coordination as a framework within which the U.S. international tax regime might be reformed.

In spite of being largely ignored by legal academics, tax coordination and tax harmonization have received considerable attention from public-finance economists, who for some time now have been debating the relative desirability of tax coordination and tax harmonization on the one hand and of tax competition on the other.[85] Given their greater depth of experience in this area, it is only

82. *See, e.g.*, Green, *supra* note 21, at 63-66 (brief discussion of harmonization); Warren, *supra* note 21, at 609-10 (same). Of late, increasing awareness of "harmful" tax competition and the tax issues raised by electronic commerce have, however, engendered debate over the need for coordinated, multilateral solutions to common international tax problems. *See, e.g.*, ORG. FOR ECON. CO-OPERATION & DEV., HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE 37-59 (1998); Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573 (2000); Julie Roin, *Competition and Evasion: Another Perspective on International Tax Competition*, 89 GEO. L.J. 543 (2001); Charles E. McClure, Jr., *Taxation of Electronic Commerce: Economic Objectives, Technological Constraints, and Tax Laws*, 52 TAX L. REV. 269 (1997); Clayton W. Chan, *Taxation of Global E-Commerce on the Internet*, 9 MINN. J. GLOBAL TRADE 233 (2000).

83. *See, e.g.*, Brian J. Arnold & Neil H. Harris, *NAFTA and the Taxation of Corporate Investment: A View from Within NAFTA*, 49 TAX L. REV. 529, 577-92 (1994); Tracy A. Kaye, *European Tax Harmonization and the Implications for U.S. Tax Policy*, 19 B.C. INT'L & COMP. L. REV. 109 (1996); Paul R. McDaniel, *Formulary Taxation in the North American Free Trade Zone*, 49 TAX L. REV. 691, 698-702 (1994); Stephen G. Utz, *Tax Harmonization and Coordination in Europe and America*, 9 CONN. J. INT'L L. 767 (1994).

84. *See, e.g.*, Arthur J. Cockfield, *Tax Integration Under NAFTA: Resolving the Conflict Between Economic and Sovereignty Interests*, 34 STAN. J. INT'L L. 39, 60 n.108 (1998); Paul R. McDaniel, *Trade and Taxation*, 26 BROOK. J. INT'L L. 1621, 1639-40 (2001); Roin, *supra* note 82, at 544, 548-49; Miranda Stewart, *Commentary*, 54 TAX L. REV. 111, 116-18 (2000).

85. Julian S. Alworth, *Taxation, Financial Innovation, and Integrated Markets: Some Implications for Tax Coordination in the European Union*, *in* THE ECONOMICS OF GLOBALIZATION: POLICY PERSPECTIVES FROM PUBLIC ECONOMICS 187, 187 (Assaf Razin & Efraim Sadka eds., 1999); A. Lans Bovenberg, *International Coordination of Tax*

natural that public-finance economists have more precisely refined the concepts of "tax coordination" and "tax harmonization." For this reason, recourse will be had to the public-finance economics literature in order to synthesize definitions for the terms "tax coordination" and "tax harmonization," and thereby forge a working vocabulary for use in the remainder of this Article.

A. *"Tax Harmonization"*

Tax harmonization "is generally understood as a process of adjusting [the] tax systems of different jurisdictions in the pursuit of a common policy objective."[86] "Complete" tax harmonization would result in each country having exactly the same tax system; in other words, each country would have the same types of taxes, and those taxes would be imposed on the same tax base at the same tax rates.[87] Tax harmonization necessarily involves high levels of intergovernmental cooperation and "may require agreement on regional standards or world standards."[88] Consequently, "tax harmonization in some sense presupposes the process of establishing a wider regional economic grouping which may be based on factors other than comparable economic strength such as geographic proximity."[89]

The best-known example of a regional economic grouping that has attempted tax harmonization is the European Union (EU).[90] The EU has endeavored to harmonize both its Member States' direct and indirect taxes.[91] While the EU has been able to make some progress toward the harmonization of indirect taxes, it has been much less successful in its attempts at harmonizing direct taxes.[92] But even at

---

Policies, *in* THE REALITY OF INTERNATIONAL ECONOMIC POLICY COORDINATION 127, 141-42 (H.J. Blommestein ed., 1991).

86. George Kopits, *Overview*, in TAX HARMONIZATION IN THE EUROPEAN COMMUNITY: POLICY ISSUES AND ANALYSIS 1, 3 (George Kopits ed., 1992).

87. Simon James, *Can We Harmonise Our Views on European Tax Harmonisation?*, 54 BULL. FOR INT'L FISCAL DOCUMENTATION 263, 264 (2000); RICHARD A. MUSGRAVE, FISCAL SYSTEMS 238-39 (1969); VITO TANZI, TAXATION IN AN INTEGRATING WORLD 9 (1995).

88. Henry J. Aaron et al., *Preface* to TANZI, *supra* note 87, at xi, xxii.

89. Angelo G.A. Faria, *Tax Coordination and Harmonization*, *in* TAX POLICY HANDBOOK 229, 229 (Parthasarathi Shome ed., 1995).

90. *Id.*

91. An example of a "direct" tax is the income tax, and an example of an "indirect" tax is a sales tax on goods and services.

92. *See* John Hawksworth, *The Slow Process of Business Tax Harmonization in the New Europe*, 10 J. INT'L TAX'N 36 (1999).

its most successful, the EU has managed to achieve only a partial harmonization of its Member States' taxes.[93]

With respect to the harmonization of indirect taxes, the EU's signal achievement was the establishment of "a common system of value-added taxation" in place of the Member States' pre-existing turnover taxes.[94] As described above, complete tax harmonization would not only require the EU Member States to adopt the same type of tax, but would also require them to adopt the same tax base and the same tax rates. The EU's common system of value-added taxation has fallen far short of this definition of complete tax harmonization because, when that system was implemented, each EU Member State was permitted to devise its own value-added tax regime.[95] Thus, although the EU Member States each adopted the same type of tax (i.e., a value-added tax in place of a turnover tax), they did not adopt either the same tax rates or the same tax base.[96]

With respect to the harmonization of direct taxes, the focus in the EU has been on corporate income taxes, rather than on personal income taxes.[97] After discussing the complete harmonization of corporate income taxes for nearly thirty years, the EU "abandoned the idea of comprehensive corporate tax harmonization" in 1990 in favor of an approach that "emphasized ... the coordination and

---

93. H. Onno Ruding, *Tax Harmonization in Europe: The Pros and Cons*, 54 TAX L. REV. 101 (2000).

94. Utz, *supra* note 83, at 791. *See also* Jan E. Brinkmann & Andreas O. Riecker, *European Company Taxation: The Ruding Committee Report Gives Harmonization Efforts a New Impetus*, 27 INT'L LAW. 1061, 1062-63 (1993). The Member Countries' turnover taxes were "levied on gross sales each time the goods turned over." Alan Schenk, *Value Added Tax: Does This Consumption Tax Have a Place in the Federal Tax System?*, 7 VA. TAX REV. 207, 229 (1987). The turnover taxes "therefore encouraged vertical integration of operations to reduce the total tax burden on goods that proceeded through multiple stages of production and distribution." *Id.* "In contrast, the additive and subtractive methods of calculating [value-added tax] provide tax neutrality between the nonintegrated and integrated firms by eliminating from the tax base the value added that already was taxed at previous stages." *Id.*

95. Brinkmann & Riecker, *supra* note 94, at 1062-63; Utz, *supra* note 83, at 791.

96. The potential for divergence in EU value-added tax rates was partially mitigated by the establishment in 1993 of a standard minimum rate and a floor on reduced rates for specified categories of goods and services. Brinkmann & Riecker, *supra* note 94, at 1062-63; Utz, *supra* note 83, at 791. The Council of the European Union recently extended the applicability of the standard minimum rate through December 31, 2005. Council Directive 2001/4/EC of 19 January 2001 Amending the Sixth Directive (77/388/EEC) on the Common System of Value Added Tax, with Regard to the Length of Time During which the Minimum Standard Rate Is to Be Applied, art. 1, 2001 O.J. (L22) 17, 17, as corrected at 2001 O.J. (L26) 40, 40. For a recent compilation of the varying value-added tax rates in EU Member States as well as an argument against harmonizing value-added tax rates, *see* ALFRED BOSS, DO WE NEED TAX HARMONIZATION IN THE EU? 2, 5-10 (The Kiel Inst. of World Econ., Working Paper No. 916, 1999).

97. Kaye, *supra* note 83, at 116.

approximation of tax policies rather than a systematic harmonization."[98] To date, the EU has made only limited progress in coordinating its Member States' corporate income taxes. The coordination measures that have been adopted thus far are the Parent-Subsidiary Directive,[99] the Mergers Directive,[100] and an Arbitration Convention.[101]

- The Parent-Subsidiary Directive "is designed to eliminate double taxation of profits distributed in the form of dividends by a subsidiary in one Member State to its parent company established in another Member State."[102]
- The Mergers Directive "defer[s] or eliminat[es] gains at the corporate level in mergers, divisions, transfers of assets, or exchanges of shares involving corporations from multiple [EU] countries."[103]
- The Arbitration Convention is "designed to eliminate the double taxation resulting from adjustments made by one tax authority that are not accompanied by a corresponding adjustment by the

---

98. Brinkmann & Riecker, *supra* note 94, at 1065. The subject of tax coordination in the EU has, however, recently resurfaced in light of (among other things) increasing globalization, the rise in electronic commerce, increasing sensitivity to the problems created by "harmful" tax competition, and the advent of the monetary union of certain EU Member States. *See, e.g.*, Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee: Towards an Internal Market Without Tax Obstacles—A Strategy for Providing Companies with a Consolidated Corporate Tax Base for their EU-wide Activities, COM(2001) 582 final, *available at* http://europa.eu.int/eur-lex/en/com/cnc/2001/com2001_0582en01.pdf; Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee: Tax Policy in the European Union – Priorities for the Years Ahead, 2001 O.J. (C 284/03) 6; Frits Bolkestein, *Taxation and Competition: The Realization of the Internal Market*, 40 EUR. TAX'N 401 (2000); W.J. Bos, *The Changing World of European Tax Policy*, 40 EUR. TAX'N 409 (2000); John Chown, *Monetary Union and Tax Harmonization*, 28 INTERTAX 102 (2000); Barbara Hendricks, *A View on Tax Harmonization and the Code of Conduct*, 40 EUR. TAX'N 413 (2000); Sylvain R.F. Plasschaert, *Comprehensive Approaches to EU Company Taxation: To Which Companies Should They Apply?*, 42 EUR. TAX'N 7 (2002); H. Onno Ruding, *The Long Way to Removing Obstacles in Company Taxation in Europe*, 42 EUR. TAX'N 3 (2002).

99. Council Directive 90/435/EEC of 23 July 1990 on the Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States, 1990 O.J. (L 225) 6.

100. Council Directive 90/434/EEC of 23 July 1990 on the Common System of Taxation Applicable to Mergers, Divisions, Transfers of Assets and Exchanges of Shares Concerning Companies of Different Member States, 1990 O.J. (L 225) 1.

101. Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises (90/436/EEC), 1990 O.J. (L 225) 10.

102. Brinkmann & Riecker, *supra* note 94, at 1065.

103. Kaye, *supra* note 83, at 137.

other Member State's tax authority, for example, in the area of transfer pricing."[104]

As this brief description demonstrates, "[t]he experience with regional tax harmonization has been only modestly encouraging."[105] The difficulty encountered by the EU in achieving tax harmonization has been attributed to the differing approaches that its Member States have taken to taxation (as well as to the need for *each* of the Member States to agree to tax measures).[106] In turn, the Member States' differing approaches to taxation have been attributed to their unique political, economic, and social structures.[107] The disappointing record of regional tax harmonization may, therefore, be explained by reference to the general incompatibility of tax harmonization with the recognition and preservation of the underlying cultural norms of the countries that comprise the relevant geographic region. In fact, this incompatibility has led some economists to argue generally against tax harmonization and in favor of tax coordination, which, as described below, is better capable of co-existing with heterogeneity both in public-sector choices and in choices regarding the social and economic policies to be implemented through the tax laws.[108]

B. *"Tax Coordination"*

Like tax harmonization, tax coordination implies the adjustment of national tax policies;[109] however, tax coordination encompasses a much broader range of adjustments than does tax harmonization. Strictly viewed, tax coordination includes *any* adaptation of one country's tax system to that of another, so long as "the objective is not

---

104. *Id.* at 139.

105. Faria, *supra* note 89, at 229. *See also* TANZI, *supra* note 87, at 9 ("Even the European Union has not been very successful in pushing forward the process of tax harmonization in its member countries.").

106. Kaye, *supra* note 83, at 129.

107. *See* Bovenberg, *supra* note 85, at 141; ARTHUR DALE, TAX HARMONIZATION IN EUROPE 24 (1963); Green, *supra* note 21, at 65; Richard J. Vann, *Improving Tax Law Improvement: An International Perspective*, 12 AUSTL. TAX F. 193, 201-03 (1995). *See generally* Burns, *supra* note 77, at 39-40.

108. *See* Bovenberg, *supra* note 85, at 141-43; James, *supra* note 87, at 266-69; Kopits, *supra* note 86, at 4. *See also* MUSGRAVE, *supra* note 87, at 238-39 (characterizing complete tax harmonization as an approach that throws the baby out with the bath water, and adopting the view that tax coordination is more appropriate because it provides "a framework within which individual countries are permitted maximum freedom in arranging their own tax structures"); Hans-Werner Sinn, *Tax Harmonization and Tax Competition in Europe*, 34 EUR. ECON. REV. 489, 489, 500-02 (1990) (eschewing both complete harmonization and unfettered competition in favor of "a collectively planned harmonization" that would allow Europe to retain "its social achievements").

109. *See* Aaron, *supra* note 88, at xxii.

to increase the overall tax burden."[110] Thus, in contrast to tax harmonization, tax coordination "does not imply uniformity of individual taxes between countries, much less uniformity of their tax systems."[111] Because tax coordination does not embrace a single level of adaptation, it may be conceptualized as a gradation that begins at one end with unfettered tax competition (i.e., the complete absence of tax coordination) and that eventually leads up to complete tax harmonization (i.e., the complete absence of tax competition).[112]

Tax coordination may be subdivided into the following two general categories based on the genesis of the coordination: "concerted" tax coordination and "spontaneous" tax coordination.[113]

1. "Concerted" Tax Coordination

"Concerted" tax coordination is a cooperative endeavor in which "bargaining occurs and governments agree to behave differently from the ways they would have behaved without the agreement."[114] A now familiar example of concerted tax coordination is the bilateral tax treaty. Notwithstanding the development of model tax treaties that have led to a standardization of general format, the particular terms of bilateral tax treaties are by no means uniform and are generally the product of a "slow and arduous" negotiating process.[115] Bilateral tax treaties have been employed to coordinate tax systems in a number of ways.[116] Four of these ways are discussed below.

a. Resolving Residence Conflicts

Bilateral income tax treaties may resolve conflicts between the contracting states with regard to the residence of an individual taxpayer, and, in some cases, a corporate taxpayer as well. If an individual is considered a resident of both contracting states under their respective domestic tax laws, then the individual may be subject to tax on her worldwide income in both countries. For example, if an individual who is a lawful permanent resident of the United States spends part of the year abroad, she may be considered a resident both of the United States (by virtue of her status as a lawful permanent

---

110. Faria, *supra* note 89, at 229.
111. *Id.*
112. James, *supra* note 87, at 264-65 (containing a graphic depiction of the potential degrees of tax coordination, from the complete absence of tax coordination to the complete harmonization of tax systems). *See also* Faria, *supra* note 89, at 229.
113. Kopits, *supra* note 86, at 4-5. *See also* TANZI, *supra* note 87, at 8.
114. Aaron, *supra* note 88, at xxii.
115. AM. LAW INST., *supra* note 5, at 2-4, 12 (1992).
116. *See id.* at 5-11.

resident)[117] and of the foreign country in which she spends a portion of the year (by virtue of her presence there). If so, then she may be subject to tax on her worldwide income both in the United States and in the foreign country. Most income tax treaties contain a set of "tie-breaker" rules that resolve this conflict by allocating the jurisdiction to tax on the basis of residence to one contracting state alone.[118]

b. Resolving Source Conflicts

Bilateral income tax treaties may resolve conflicts between the source rules of the contracting states. Source rules are relevant in determining (i) the extent to which a contracting state can exercise its jurisdiction to tax the income of nonresidents (because nonresidents are normally subject to tax only on items of income that are considered to be derived from sources *within* the contracting state) and (ii) whether a contracting state is required to cede all or a portion of its jurisdiction to tax the income of its residents (because the alleviation of double taxation through the provision of either an exemption or a tax credit is normally confined to items of income that are considered to be derived from sources *without* the contracting state). Absent a treaty, both contracting states might consider the same item of income to be derived from different sources, which might cause the taxpayer to be subject to tax on that item of income in both countries—without any alleviation of this double taxation by the residence country through the provision of an exemption or a tax credit.[119] Many income tax treaties contain provisions that are designed to resolve these and other source conflicts.[120]

c. Prohibiting Discrimination

Bilateral income tax treaties may attempt to establish a level playing field on which residents of the two contracting states can compete.[121] To this end, many income tax treaties contain a provision that prohibits each contracting state from imposing on nationals of the other contracting state, or on businesses of the contracting state owned by residents of the other contracting state, taxes or requirements that are other or more burdensome than the taxes or

---

117. I.R.C. § 7701(b)(1)(A)(i) (2001); Treas. Reg. § 1.1-1(b) (2001).

118. *See, e.g.*, MODEL TAX CONVENTION ON INCOME AND ON CAPITAL, art. 4, paras. 2-3 (Org. for Econ. Co-operation & Dev. 1997), *reprinted in* 1 Tax Treaties (CCH) ¶ 191.04 (2000); U.S. MODEL INCOME TAX CONVENTION, art. 4, paras. 2-4 (1996), *reprinted in* 1 Tax Treaties (CCH) ¶ 214.04, at 10,601 (1999).

119. *See supra* Part II.C. for an example of this problem.

120. PETER H. BLESSING, INCOME TAX TREATIES OF THE UNITED STATES ¶ 18.02 (1996).

121. *See* AM. LAW INST., *supra* note 5, at 253.

requirements imposed on nationals or similar businesses of that contracting state.[122] It is worth noting, however, that, although treaty nondiscrimination provisions will negate the application of blatantly discriminatory taxes and other requirements, they may prove difficult to apply in less obvious cases.[123] The ambiguity of nondiscrimination provisions also opens them up to manipulation by contracting states that wish to enact tax provisions that have discriminatory effects on nonresidents, but that do not wish to admit the existence of those effects.[124]

d. Unique Domestic Law

Bilateral income tax treaties may address the application of unique provisions in the domestic laws of one of the contracting states to residents of the other contracting state. For example, the income tax treaty between the United States and Mexico addresses the application of the permanent establishment threshold for taxing business profits to maquiladoras;[125] the income tax treaty between the United States and China permits China, in the case of specific industries, to attribute profits to a permanent establishment on the basis of deemed profits;[126] and the income tax treaty between the United States and Israel contains a provision that accords favorable U.S. tax treatment to certain cash grants made by the government of Israel to promote investment in Israel.[127]

---

122. *See, e.g.*, MODEL TAX CONVENTION ON INCOME AND ON CAPITAL, art. 24 (Org. for Econ. Co-operation & Dev. 1997), *reprinted in* 1 Tax Treaties (CCH) ¶ 191.24 (2000); U.S. MODEL INCOME TAX CONVENTION, art. 24 (1996), *reprinted in* 1 Tax Treaties (CCH) ¶ 214.24 (1999). The desirability of treaty nondiscrimination provisions is not, however, universally recognized. For example, Australia, Canada, and New Zealand have reserved their positions on the nondiscrimination article in the Model Tax Convention prepared by the Organisation for Economic Co-operation and Development. MODEL TAX CONVENTION ON INCOME AND ON CAPITAL, art. 24 cmt. ¶ 64 (Org. for Econ. Co-operation & Dev. 1997).

123. AM. LAW INST., *supra* note 5, at 11, 253-83; Sanford H. Goldberg & Peter A. Glicklich, *Treaty-Based Nondiscrimination: Now You See It Now You Don't*, 1 FLA. TAX REV. 51 (1992).

124. BLESSING, *supra* note 120, ¶ 20.01[1]; Goldberg & Glicklich, *supra* note 123, at 73-81, 93-97.

125. Convention Between the Government of the United States of America and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Sept. 18, 1992, U.S.-Mex., art. 5, para. b, S. TREATY DOC. NO. 103-7, at 10 (1993).

126. Agreement Between the Government of the United States of America and the Government of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Tax Evasion with Respect to Taxes on Income, Apr. 30, 1984, U.S.-P.R.C., art. 7, para. 4, S. TREATY DOC. NO. 98-30, at 5 (1984).

127. Convention Between the Government of the United States of America and the Government of Israel with Respect to Taxes on Income, Nov. 20, 1975, U.S.-Isr.,

2. "Spontaneous" Tax Coordination

The other general category of tax coordination is "spontaneous" tax coordination. Spontaneous tax coordination is unilateral in nature. In other words, unlike concerted tax coordination, spontaneous tax coordination does not involve negotiations between, or overt cooperation among, different nations.[128] As described more fully below, spontaneous tax coordination can result from either (i) tax competition (STC/Tax Competition),[129] (ii) employing comparative law as an aid to legislation (STC/Comparative Law),[130] or (iii) coincidence (STC/Coincidence).[131]

An example of an event that gave rise to STC/Tax Competition is the enactment of the "portfolio interest exemption" by the United States. Under its domestic laws, the United States normally imposes a thirty percent withholding tax on payments of U.S. source passive income (e.g., interest) made to foreign persons.[132] In 1984, the United States abolished this withholding tax insofar as it applies to "portfolio interest."[133] Following the enactment of the portfolio interest exemption, "[o]ne after another, all the major economies . . . abolished their withholding taxes on interest for fear of losing mobile capital flows to the United States."[134] Thus, as a result of competitive forces, the United States' abolition of its withholding tax on portfolio interest led to the spontaneous coordination of developed countries' withholding tax rates on interest income.

An example of coordination that may be the product of STC/Tax Competition and/or STC/Coincidence is the widespread lowering of marginal corporate income tax rates and broadening of the corporate income tax base that took place from the mid-1980s through the early 1990s. Economists began to document this spontaneous coordination shortly after the United States enacted the Tax Reform Act of 1986,[135] and its existence was later confirmed in a retrospective piece

---

art. 10, S. EXEC. DOC. C, 94-2, at 10 (1976), Protocol, art. VII, S. EXEC. DOC. M, 96-2, at 3 (1980).

128. *See* Bovenberg, *supra* note 85, at 142-43; Faria, *supra* note 89, at 229; Kopits, *supra* note 86, at 4.

129. *See* Bovenberg, *supra* note 85, at 142; Kopits, *supra* note 86, at 4.

130. *See* DALE, *supra* note 107, at 23.

131. *See infra* note 137 and accompanying text. *See also* Vann, *supra* note 107, at 206.

132. I.R.C. §§ 871(a), 881(a) (2001).

133. Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 127, 98 Stat. 494, 648-53 (1984) (codified as amended at I.R.C. §§ 871(h), 881(c) (2001)). For a definition of portfolio interest, *see* I.R.C. § 871(h).

134. Avi-Yonah, *supra* note 82, at 1581.

135. *See* WORLD TAX REFORM: A PROGRESS REPORT (Joseph A. Pechman ed., 1988); John Bossons, *International Tax Competition: The Foreign Government Response in Canada and Other Countries*, 41 NAT'L TAX J. 347 (1988); John Bossons, *The Impact of the 1986 Tax Reform Act on Tax Reform in Canada*, 40 NAT'L TAX J. 331 (1987); Vito

building on this earlier work.[136] There has been some question, however, about whether this coordination can be ascribed to competitive forces, to common intellectual influences that were connected with a change in the political environment, or to some combination of the two.[137]

An example of STC/Comparative Law is the recent proliferation of "anti-deferral regimes." Anti-deferral regimes are enacted to combat the erosion of a country's tax base that may occur when its residents defer taxation by earning income through a controlled foreign corporation. Tax may be deferred in this way by exploiting the differences between the taxation of domestic and foreign persons. Many countries, including the United States, tax their residents on a worldwide basis, but tax foreign persons only on their income from domestic sources.[138] Because these countries also respect the status of corporations as separate legal entities, resident taxpayers are able to reduce their domestic tax liability by interposing a foreign corporation between them and assets or businesses that produce foreign source income.[139] For example, if a U.S. person were to create a foreign corporation to hold assets that produce foreign source income or to operate a foreign business, the U.S. person would be able to defer U.S. tax on the income generated by those assets or that business until the controlled foreign corporation paid a dividend. This deferral would redound to the U.S. person's benefit so long as the tax imposed by the foreign jurisdiction of incorporation was lower than that imposed by the United States, and, naturally, the value of deferral would be maximized if the controlled foreign corporation were incorporated in a low- or no-tax jurisdiction (i.e., a tax haven).[140] Moreover, due to the time value of money, the longer the U.S. person could defer repatriation of income from the foreign corporation, the

---

Tanzi, *The Response of Other Industrial Countries to the U.S. Tax Reform Act*, 40 NAT'L TAX J. 339 (1987).

136. Haroldene F. Wunder & Stephen R. Crow, *International Tax Reform Since 1986: An Update*, 14 TAX NOTES INT'L 1163 (1997).

137. Harry Grubert et al., *Country and Multinational Company Responses to the Tax Reform Act of 1986*, 49 NAT'L TAX J. 341 (1996); Tanzi, *supra* note 135, at 339-40; John Whalley, *Foreign Responses to U.S. Tax Reform*, *in* DO TAXES MATTER 286 (Joel Slemrod ed., 1990).

138. TREASURY REPORT ON SUBPART F, *supra* note 26, at ix-x; BRIAN J. ARNOLD, THE TAXATION OF CONTROLLED FOREIGN CORPORATIONS: AN INTERNATIONAL COMPARISON 3 (Can. Tax Found. Paper No. 78, 1986). The United States also taxes its citizens on their worldwide income, whether they reside within or without the United States. Treas. Reg. § 1.1-1(b) (2001).

139. TREASURY REPORT ON SUBPART F, *supra* note 26, at 1-3.

140. ORG. FOR ECON. CO-OPERATION & DEV., STUDIES IN TAXATION OF FOREIGN SOURCE INCOME: CONTROLLED FOREIGN COMPANY LEGISLATION 10-12, 16 (1996) [hereinafter OECD, CFC REPORT]; ARNOLD, *supra* note 138, at 5-6.

greater the reduction that would be achieved in the U.S. tax burden.[141]

To counter the potentially harmful effects of such deferral, the United States enacted its "foreign personal holding company" regime in 1937[142] and its "controlled foreign corporation" regime, also referred to as "Subpart F," in 1962.[143] These regimes eliminate deferral with respect to certain types of income earned through foreign corporations that are closely-held by U.S. persons.[144] Both regimes generally eliminate deferral with respect to passive income such as interest, dividends, rents, and royalties.[145] Subpart F further eliminates deferral with respect to income from mobile business operations that are easily transferred to low- or no-tax jurisdictions.[146] Following the example set by the United States, a number of countries have taken steps to eliminate what they perceive to be the abusive deferral of tax on income earned through controlled foreign corporations; however, the details of such legislation vary widely by country.[147] Nonetheless, with the exception of the United States, the countries that have enacted anti-deferral regimes have considered—and borrowed from—the extant regimes when formulating their own responses to this problem.[148]

---

141. OECD, CFC REPORT, *supra* note 140, at 16; ARNOLD, *supra* note 138, at 6.

142. Revenue Act of 1937, Pub. L. No. 75-377, § 201, 50 Stat. 813, 818-24 (1937) (currently codified as amended at I.R.C. §§ 551-58 (2001)). For a description of the events leading up to the enactment of the foreign personal holding company regime, see TREASURY REPORT ON SUBPART F, *supra* note 26, at 4-7.

143. Revenue Act of 1962, Pub. L. No. 87-834, § 12, 76 Stat. 960, 1006-31 (1962) (currently codified as amended at I.R.C. §§ 951-64 (2001)). For a description of the events leading up to the enactment of Subpart F, see TREASURY REPORT ON SUBPART F, *supra* note 26, at 8-9, 12-22.

144. I.R.C. §§ 552, 957 (2001).

145. I.R.C. §§ 552-53, 954(c) (2001).

146. I.R.C. § 954(d), -(e) (2001). Note that neither regime is intended to eliminate deferral with respect to most "active" business income. Deferral with respect to active business income was retained for fear that its elimination would put U.S. multinational corporations at a competitive disadvantage. TREASURY REPORT ON SUBPART F, *supra* note 26, at 22; Reuven S. Avi-Yonah, *U.S. Notice 98-11 and the Logic of Subpart F: A Comparative Perspective*, 16 TAX NOTES INT'L 1797 (1998); Peroni et al., *supra* note 53, at 476-77.

147. TREASURY REPORT ON SUBPART F, *supra* note 26, at 58-61; ARNOLD, *supra* note 138, at 12, 127-31. Most recently, the U.S. Department of the Treasury put at twenty the number of countries with such legislation, and it indicated that another country has expressed its intention to enact such legislation. TREASURY REPORT ON SUBPART F, *supra* note 26, at 58 n.10.

148. RICHARD A. GORDON, U.S. DEP'T OF TREASURY, TAX HAVENS AND THEIR USE BY UNITED STATES TAXPAYERS: AN OVERVIEW 24-26 (1981); OECD, CFC REPORT, *supra* note 140, at 21-29; ARNOLD, *supra* note 138, at 406; Reuven S. Avi-Yonah, *Comment on Shay and Summers: Selected International Aspects of Fundamental Tax Reform Proposals*, 51 U. MIAMI L. REV. 1085, 1087 (1997).

IV. THE PROPOSED FRAMEWORK IN THEORY

With these refined concepts of tax coordination and tax harmonization in mind, this Part explores the viability of adopting tax coordination as a framework within which the U.S. international tax regime might be reformed. The analysis below will proceed as follows: In Subpart A, the appropriate method of tax coordination will be determined. In Subpart B, the manner in which the proposed framework is expected to operate in theory will be detailed. Finally, in Subpart C, the costs and benefits of the proposed framework will be considered.

A. *The Appropriate Method of Coordination*

Before delving into a discussion of the appropriate method of coordination to be used as a basis for the framework, it is necessary to make a distinction between "levels" and "methods" of tax coordination. As described above, tax coordination may be thought of as a continuum, with unfettered tax competition at one extreme and complete tax harmonization at the other.[149] This continuum conceptualizes the many possible "levels" of tax coordination, which range from little or no coordination to a high degree of coordination and include the infinite number of gradations that lie in between. Concerted and spontaneous tax coordination, on the other hand, are "methods," and not levels, of coordination. In the case of concerted tax coordination, the desired level of coordination is achieved through bilateral or multilateral action. In the case of spontaneous tax coordination, the desired level of coordination is achieved through unilateral action. Consequently, insofar as the appropriate "method" of coordination is concerned, the choice must be made between concerted and spontaneous tax coordination—neither unfettered tax competition nor complete tax harmonization is a possible choice because they are each levels, and not methods, of coordination.

Of these two possible methods of coordination, spontaneous tax coordination proves the more appropriate for adoption as a basis for the framework. All that is required to reform the U.S. international tax regime is the enactment of legislation that either eliminates, modifies, or augments existing international tax rules. As a result, only methods of coordination that involve unilateral action on the part of the United States will be congruent with the task of reforming the U.S. international tax regime. For this reason, concerted tax coordination, which presupposes action by the United States in concert with one or more other nations, may be eliminated from

149. *See supra* note 112 and accompanying text.

consideration.[150] In contrast, spontaneous tax coordination, which presupposes only unilateral action on the part of the United States, is congruent with the task of reforming the U.S. international tax regime.

Of the three types of spontaneous tax coordination described above, STC/Comparative Law is best suited for adoption as a basis for the framework. Neither STC/Coincidence nor STC/Tax Competition is particularly well-suited to this task—STC/Coincidence because it relies on happenstance to achieve coordination, and STC/Tax Competition because, like concerted tax coordination, it presupposes action not only on the part of the United States but also on the part of other countries. STC/Comparative Law proves to be the most appropriate method of coordination because it involves only unilateral action on the part of the United States in reviewing and evaluating the international tax rules adopted by other countries.

B. *The Proposed Framework in Operation*

Having determined that STC/Comparative Law is the most appropriate method of coordination for use as a basis for the framework, the manner in which STC/Comparative Law is expected to operate in theory will now be detailed. In a departure from current legislative practice, STC/Comparative Law would require U.S. policymakers to make a conscious, unilateral effort to ascertain the international tax rules in force in other countries and then to compare and contrast those rules in order to determine the most suitable rule for enactment by the United States. For some time now, other countries have employed such a comparative analysis in the formation of their tax legislation.[151] The United States, which generally views itself as a leader rather than a follower in international tax matters,[152] has not, however, devoted much attention to foreign tax systems when developing its domestic tax

---

150. It is also worth noting that the United States already engages in concerted tax coordination through the negotiation and renegotiation of bilateral income tax treaties. The United States' success in its efforts at concerted tax coordination have, however, been undermined by Congress, which has with increasing frequency been enacting legislation that is intended to override inconsistent provisions in bilateral income tax treaties. *See* Infanti, *supra* note 79, at 681-83.

151. *See, e.g.*, text accompanying notes 138-148; DALE, *supra* note 107, at 23.

152. Avi-Yonah, *Proposal for Simplification*, *supra* note 11, at 1352; Ross, *supra* note 17.

laws.[153] Moreover, at the academic level, comparative tax law has been "slighted" by U.S. scholars.[154]

Because comparative analysis lies at the heart of the proposed framework but has been neglected by U.S. tax academics and policymakers, a brief discussion of the comparative method will be necessary before proceeding further. Comparative law scholars have found it difficult precisely to define the methodology of comparative analysis;[155] indeed, many scholars have simply avoided addressing the question at all.[156] Nevertheless, "[t]he closest attempt by a recognised text at providing some guidance on method remains that of Zweigert and Kötz."[157] Professors Zweigert and Kötz "advocate a

---

153. *See* Charles I. Kingson, *The Coherence of International Taxation*, 81 COLUM. L. REV. 1151 (1981) (arguing that U.S. international tax policy has not sufficiently taken into account other countries' reactions to its tax laws).

154. Michael A. Livingston, *Reinventing Tax Scholarship: Lawyers, Economists, and the Role of the Legal Academy*, 83 CORNELL L. REV. 365, 426 (1998) ("Comparative law is slighted by American scholars, receiving less attention than in European or other smaller countries. Comparative tax is no exception: legal scholars only rarely discuss foreign precedents in addressing domestic tax issues."). *But see* HUGH J. AULT ET AL., COMPARATIVE INCOME TAXATION: A STRUCTURAL ANALYSIS (1997); CHRISTOPHER H. HANNA, COMPARATIVE INCOME TAX DEFERRAL: THE UNITED STATES AND JAPAN (2000); COMPARATIVE TAX SYSTEMS: EUROPE, CANADA, AND JAPAN (Joseph A. Pechman ed., 1987); William B. Barker, *A Comparative Approach to Income Tax Law in the United Kingdom and the United States*, 46 CATH. U. L. REV. 7 (1996); Ernest R. Larkins, *Double Tax Relief for Foreign Income: A Comparative Study of Advanced Economies*, 21 VA. TAX REV. 233 (2001); Ann F. Thomas, *Square Wheels: U.S. Pass-Through Taxation of Privately Held Enterprises in a Comparative Law Context*, 17 N.Y.L. SCH. J. INT'L & COMP. L. 429 (1997).

155. *See, e.g.*, Hiram E. Chodosh, *Comparing Comparisons: In Search of Methodology*, 84 IOWA L. REV. 1025, 1030 (1999) ("comparative legal studies has not explained adequately what *the* comparative method is or should be"); John Henry Merryman, *Comparative Law Scholarship*, 21 HASTINGS INT'L & COMP. L. REV. 771, 771 (1998) ("Most comparative lawyers know that their field enjoys, or endures, what generous observers might praise as a healthy scholarly pluralism but more knowledgeable people decry as the sort of scholarly confusion that results from a paradigm crisis."); John C. Reitz, *How to Do Comparative Law*, 46 AM. J. COMP. L. 617, 617-18 (1998) (asserting that, while there is no "official canon of great works for writing in the field to emulate," there is "really a large degree of consensus about the essentials of the comparative method"); Annelise Riles, *Wigmore's Treasure Box: Comparative Law in the Era of Information*, 40 HARV. INT'L L.J. 221, 224 (1999) ("a collective crisis of methodological confidence is something of a defining genre of comparative legal scholarship").

156. Chodosh, *supra* note 155, at 1044-57.

157. PETER DE CRUZ, COMPARATIVE LAW IN A CHANGING WORLD 233 (1999). *See also* Vivian Grosswald Curran, *Cultural Immersion, Difference and Categories in U.S. Comparative Law*, 46 AM. J. COMP. L. 43, 66 (1998) (indicating that Professors Zweigert and Kötz's book on comparative law is "much used in the United States"); Ahmed A. White, *Max Weber and the Uncertainties of Categorical Comparative Law*, *in* RETHINKING THE MASTERS OF COMPARATIVE LAW 40, 54 (Annelise Riles ed., 2001) (describing Professors Zweigert and Kötz's book on comparative law as "the main introductory treatise in the field").

functionalist perspective for comparative legal studies":[158] "The basic methodological principle of all comparative law is that of *functionality*. From this basic principle stem all the other rules which determine the choice of laws to compare, the scope of the undertaking, the creation of a system of comparative law, and so on."[159] Viewing comparative law from this functionalist perspective, Professors Zweigert and Kötz have broken down the comparative method of analysis into a series of five steps.

First, the comparatist must identify the problem to be studied.[160] Professors Zweigert and Kötz remind us that "[i]ncomparables cannot usefully be compared, and in law the only things which are comparable are those which fulfil the same function."[161] Thus, the problem to be studied "must be posed in purely functional terms . . . without any reference to the concepts of one's own legal system."[162]

Second, the comparatist must choose the legal systems to be compared.[163] Which legal systems are ultimately chosen will depend in large part on the problem to be studied.[164] Illustrating the sensitivity of the choice of legal systems to the problem to be studied, Professors Zweigert and Kötz have indicated that the comparatist may generally limit herself to the parent systems of the great legal families[165] if she is to compare only the style of different families of law; may follow the rule of thumb of studying only the significant legal systems in certain legal families[166] if she is to study a "classical"

---

158. Curran, *supra* note 157, at 66.

159. KONRAD ZWEIGERT & HEIN KÖTZ, INTRODUCTION TO COMPARATIVE LAW 34 (Tony Weir trans., 3d rev. ed. 1998).

160. *Id.*

161. *Id.*

162. *Id.*

163. *Id.* at 40-41.

164. *Id.* at 41.

165. "The notion of the legal family has served as the organisational linchpin for the analysis of legal systems of the world." DE CRUZ, *supra* note 157, at 26. A variety of criteria have been proposed by comparative law scholars for dividing the legal systems of the world into different families, leading to a number of different groupings. *Id.* at 34, 36; ZWEIGERT & KÖTZ, *supra* note 159, at 63-65. Professors Zweigert and Kötz have divided the legal systems of the world into five families: (i) Romanistic, (ii) Germanic, (iii) Nordic, (iv) Common Law, and (v) others (e.g., People's Republic of China, Japan, Islamic Law, and Hindu Law). ZWEIGERT & KÖTZ, *supra* note 159, at 73. The division of legal systems into legal families may not be the same for all areas of the law; "[f]or example, it is quite possible that a system is to be put in one family for private law purposes, and in another for purposes of constitutional law." *Id.* at 65. Bearing this in mind, the income tax laws of the world have been divided into eight families: (i) British, (ii) French, (iii) American, (iv) Latin American, (v) transition countries (i.e., former socialist countries), (vi) Northern European, (vii) Southern European, and (viii) miscellaneous (e.g., Iran, Japan, and Korea). 2 TAX LAW DESIGN AND DRAFTING, at xxiv (Victor Thuronyi ed., 1998).

166. For example, Professors Zweigert and Kötz suggest the U.S. and English legal systems in the common law family, the French and Italian legal systems in the

problem of private law; and may need to include smaller countries where the problem she is to study is not a "classical" one, but rather is a "quite topical [one] with which legislators and judges all over the world are currently grappling."[167]

Third, the comparatist must prepare a separate report describing the relevant laws of each of the legal systems chosen for study.[168] These reports should delve as deeply as possible into the chosen legal systems, and should take into account the cultural, economic, and legal context of each of the systems.[169] The reports should also be "objective, that is, free from any critical evaluation, though containing all significant qualifications or modifications."[170]

Fourth, the comparatist must compare and contrast the legal systems chosen for study in an effort to identify similarities among and differences between them.[171] To compare and contrast the solutions described in the separate reports prepared in step three, each legal system's solution to the problem being studied must be freed from its conceptual context and reduced to "its functional form," so that it can "be seen purely in the light of [its] function, as an attempt to satisfy a particular legal need."[172]

Finally, the comparatist must critically evaluate what she has discovered through her comparisons.[173] This evaluation may result in the conclusion that one of the approaches to the problem is clearly better than the others, or the comparatist "may be able to fashion a new solution, superior to all others, out of parts of the different national solutions."[174]

Professors Zweigert and Kötz believe that this functionalist approach to comparative analysis will generally lead to the conclusion that different legal systems approach the same problems in the same or similar ways:

> But if we leave aside the topics which are heavily impressed by moral views or values, mainly to be found in family law and in the law of succession, and concentrate on those parts of private law which are relatively 'unpolitical', we find that as a general rule developed nations answer the needs of legal business in the same or in a very similar way.[175]

Romanistic family, and Germany and Switzerland in the Germanic family. ZWEIGERT & KÖTZ, *supra* note 159, at 41.

167. *Id.* at 42.
168. *Id.* at 43.
169. *Id.* at 36, 40.
170. *Id.* at 43.
171. *Id.*
172. *Id.* at 43-44.
173. *Id.* at 46-47.
174. *Id.* at 47.
175. *Id.* at 40.

Based on this belief, Professors Zweigert and Kötz assert that the "point of departure for the comparative enterprise [is] a '*praesumptio similitudinis*,' which they define as 'a presumption that the practical results are similar.'"[176] Professors Zweigert and Kötz further assert that the presumed similarity among legal systems can be used as a means of confirming the validity of the comparative analysis:[177]

> [A]t the end of the study the same presumption acts as a means of checking our results: the comparatist can rest content if his researches through all the relevant material lead to the conclusion that the systems he has compared reach the same or similar practical results, but if he finds that there are great differences or indeed diametrically opposite results, he should be warned and go back to check again whether the terms in which he posed his original question were indeed purely functional, and whether he has spread the net of his researches quite wide enough.[178]

The functionalist approach to comparative analysis has been criticized by commentators on the ground that it focuses on the law as a set of rules and fails initially to place the law in its wider cultural context.[179] This criticism rings particularly true in the area of

---

176. Curran, *supra* note 157, at 67.

177. *Id.*

178. ZWEIGERT & KÖTZ, *supra* note 159, at 40.

179. *See* Curran, *supra* note 157, at 51-54; Günter Frankenberg, *Critical Comparisons: Re-thinking Comparative Law*, 26 HARV. INT'L L.J. 411, 434-40 (1985); Mark Van Hoecke & Mark Warrington, *Legal Cultures, Legal Paradigms and Legal Doctrine: Towards a New Model for Comparative Law*, 47 INT'L & COMP. L.Q. 495, 495-96 (1998). *See also* William Ewald, *Comparative Jurisprudence (I): What Was It Like to Try a Rat?*, 143 U. PA. L. REV. 1889, 1894-98 (1995) (arguing that "the primary object of study for comparative law should be the *philosophical* principles that lie behind the surface of the rules" rather than a merely textualist or contextualist study of the rules themselves); Merryman, *supra* note 155, at 775-84 (predicting that much future academic scholarship in comparative law will be rule-based, but also predicting that "the opportunities for resuscitation of academic comparative law scholarship lie in the humanistic and/or scientific study of legal systems and their components and related social-legal conversion questions"); Rodolfo Sacco, *Legal Formants: A Dynamic Approach to Comparative Law* (pt. 1), 39 AM. J. COMP. L. 1, 21-34 (1991) (arguing that attempting to identify "the" legal rule in a country as a first step in comparative analysis is a "misleading simplification" because the "living law contains many different elements such as statutory rules, the formulations of scholars, and the decisions of judges," which may, in fact, conflict).

In practice, Professors Zweigert and Kötz do, in fact, place the legal rules in a wider context. *See* Joachim Zekoll, *Kant and Comparative Law - Some Reflections on a Reform Effort*, 70 TUL. L. REV. 2719, 2747-49 (1996). *See also* Curran, *supra* note 157, at 53.

> If the current generation has begun to feel obliged to articulate the necessity of a contextual or cultural immersion approach to comparative legal analysis, it is not because such a methodology would be an innovation. On the contrary, it is because the generation of émigré comparatists is retiring and dying, leaving comparative law in the United States to be taught by stop-gap, short-term visiting professors from abroad or by native-born American professors generally bereft of effective foreign-language skills. The scope of native-born American

taxation. As mentioned above, a country's approach to taxation often reflects its unique political, social, and economic structures.[180] Bearing this criticism in mind, the comparative analysis in this Article will not adhere to Professors Zweigert and Kötz's rigid functionalist approach. Instead, the comparative analysis of the tax treatment of cross-border charitable contributions, which is undertaken in Part V of this Article, will consist of three general phases: (i) a descriptive phase, (ii) an identification phase, and (iii) an explanatory phase.[181] The descriptive phase will consist of a description of the relevant legal rules in their historical and cultural context. The identification phase will consist of an identification of similarities among and differences between the approaches adopted by the countries included in the study. Finally, the explanatory phase will take into account these similarities and differences in attempting to formulate a proposal for reforming the U.S. tax rules governing the treatment of cross-border charitable contributions.

Professors Zweigert and Kötz's functionalist approach has also been criticized on the ground that it "privilege[s] findings of sameness and underestimate[s] the significance of differences."[182] This criticism also rings true in the area of taxation. Tax policy is determined by balancing a number of conflicting considerations, many of which themselves embrace a number of competing viewpoints. As changes occur in the political, social, and economic landscape of the country, the considerations that tip the balance in favor of one tax rule or another often can fluctuate. The inherently undulating nature of tax policy militates strongly against the conclusion that there are absolute tax rules that may be ascertained simply by comparing the systems of different countries. Bearing this criticism in mind, STC/Comparative Law will *not* be employed as a vehicle for achieving tax harmonization. Such a high degree of

---

> comparatists' cultural, literary, historical, social and political knowledge of civil law systems generally pales in comparison with the vast background of the classically educated European énigrés [sic] who, to borrow a phrase George Steiner once used in tribute to Robert Musil, so often seemed to carry all of Western civilization in their minds.

Id.

180. *See supra* note 107 and accompanying text.

181. *See generally* W.J. Kamba, *Comparative Law: A Theoretical Framework*, 23 INT'L & COMP. L.Q. 485, 511-12 (1974); DE CRUZ, *supra* note 157, at 233 ("many comparatists have written copiously on what a proper comparative method should consist of, but, of the published literature, only Kamba has actually suggested some 'objective' practical comparative techniques, in the sense that they make no assumptions as to ideology, culture or political persuasion").

182. Curran, *supra* note 157, at 53. *See also* Frankenberg, *supra* note 179, at 436-38. Professor Curran interestingly hypothesizes that this search for similarities (and the concomitant discounting of differences) has its roots in the Nazis' use of law as a tool for legitimizing exclusion and discrimination. Curran, *supra* note 157, at 66-78.

coordination would only be a suitable goal if comparative law could be expected to produce a single set of invariably correct international tax rules. Instead, STC/Comparative Law will serve as no more than a framework for reforming the U.S. international tax regime. By reforming the regime within the confines of a framework constructed with the aid of comparative analysis, a measure of coordination, and, in turn, simplification, should be a realistically attainable goal.

With this revised comparative analysis as a starting point, the path to reform is relatively straightforward. Comparative analysis will first aid policymakers in identifying the rules currently in place in other countries —along with any trends in the rules being adopted or abandoned by them. In this regard, comparative analysis will

> provide a much richer range of model solutions than a legal science devoted to a single nation, simply because the different systems of the world can offer a greater variety of solutions than could be thought up in a lifetime by even the most imaginative jurist who was corralled in his own system.[183]

Policymakers will then be able to compare and contrast these rules to determine which, if any, is superior to the others. Finally, policymakers will be able to determine whether, in light of all of the considerations that normally inform U.S. international tax policy-making, the superior rule, an amalgamation of existing rules, or a different rule is the most "appropriate" rule for enactment by the United States.[184] The degree of coordination ultimately achieved by employing this framework will depend on how closely this "appropriate" rule approximates the rules in place in other countries. The broad definition of "coordination" articulated above—which embraces any adaptation of one tax system to another—will imbue the framework with a great deal of flexibility and allow policymakers to vary the desired level of coordination as necessary to accommodate domestic political, economic, and social norms.[185]

C. *Assessing the Proposed Framework*

Having explained the manner in which the proposed framework is expected to operate in theory, an analysis of the costs and benefits

---

183. ZWEIGERT & KÖTZ, *supra* note 159, at 15.

184. *See* Reitz, *supra* note 155, at 624-25 ("Thus comparative studies may uncover interesting ideas for domestic law reform, but in the end the case for adoption of a foreign model cannot rest on the fact that many other countries have the rule or legal institution. The argument for domestic law reform has to be made in terms of normative claims acceptable within the domestic legal system, and probably the foreign transplant will have to be modified in significant ways precisely because each legal system reflects an at least partially unique legal system.").

185. *Cf.* Graetz, *supra* note 3, at 311-12 (summarily rejecting coordination as a guide for the formation of U.S. international tax policy, except where it happens to coincide with national interests).

of its adoption will now be undertaken. The analysis will proceed as follows: first, viewing the proposed framework from a legal perspective, its anticipated benefits will be inferred from the U.S. domestic experience in coordinating state commercial laws through the adoption of the Uniform Commercial Code; then, shifting from a legal to an economic perspective, its anticipated costs will be inferred from the longstanding debate among public-finance economists over the relative merits of tax competition and tax coordination.

1. Benefits: The Legal Perspective

Because the United States has yet to experiment with spontaneous coordination in formulating its international tax policy, an analogous situation must be adduced from which the benefits of adopting the proposed framework may be inferred. A convenient analogy exists here in the United States, where the several states have adopted the Uniform Commercial Code (UCC) in an effort to coordinate their commercial laws. Despite having occurred at the domestic rather than the international level, the adoption of the UCC is actually closely analogous to the adoption of STC/Comparative Law as a framework for reform, both in terms of the manner in which the laws being coordinated are normally adopted and in terms of the level of coordination sought.

Due to the fact that most nations jealously guard their fiscal sovereignty,[186] international tax rules are adopted at the individual state level. There are no supranational bodies governing international tax matters, and the only constraints on the ability of a state to develop or alter its international tax rules are self-imposed, taking the form of treaty obligations. In the United States, commercial law has also historically been developed at the state level.[187] Furthermore, absent federal preemption, each state is a sovereign entity that is free to adopt its own set of commercial

---

186. *See* Cockfield, *supra* note 84, at 50; ORG. FOR ECON. CO-OPERATION & DEV., TRANSFER PRICING GUIDELINES FOR MULTINATIONAL ENTERPRISES AND TAX ADMINISTRATIONS ¶ 4.35 at IV-12 (1995) (stating that the "non-mandatory nature" of corresponding adjustments between nations in transfer pricing disputes "is important to maintaining the fiscal sovereignty of each OECD Member country"); COMM. ON FISCAL AFFAIRS, ORG. FOR ECON. CO-OPERATION & DEV., TRANSFER PRICING AND MULTINATIONAL ENTERPRISES: THREE TAXATION ISSUES ¶ 115(c) (1984), *available at* LEXIS 86 TNI 7-19 (rejecting compulsory arbitration in transfer pricing disputes between nations on the ground that it "would represent an unacceptable surrender of fiscal sovereignty").

187. David M. Phillips, *Secured Credit and Bankruptcy: A Call for the Federalization of Personal Property Security Law*, 50 LAW & CONTEMP. PROBS. 53, 67 (1987); Norman Silber, *Why the U.C.C. Should Not Subordinate Itself to Federal Authority: Imperfect Uniformity, Improper Delegation and Revised Section 3-102(c)*, 55 U. PITT. L. REV. 442, 443 (1994).

laws.[188] Thus, the U.S. domestic commercial law context is rather similar to the international tax context. In both cases, most laws are formulated at the level of the individual state, and each state has generally been unrestrained in its ability to adopt laws that differ from those of other states.

The level of coordination achieved through the adoption of the UCC is also similar to the level of coordination that may be achieved through the adoption of the proposed framework. The UCC, which was the product of drafting by the National Conference of Commissioners on Uniform State Laws and the American Law Institute—with input from bar associations, law firms, business concerns, and various states[189]—has been adopted by all fifty U.S. states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands.[190] The UCC has "standardiz[ed] and streamlin[ed] the process by which commercial parties negotiate, conclude, and enforce contracts," but has by no means resulted in the adoption of a completely uniform set of commercial laws. Indeed, the UCC itself contains alternative formulations of certain rules from which states can choose. In addition, the UCC has been the subject of local variation, sometimes referred to as "nonuniform" amendment, by the adopting states.[191] This flexible approach to "uniformity" is closer to the notion of spontaneous tax coordination examined in this Article than the title of the UCC would suggest.

Given the similarities between the UCC and spontaneous tax coordination, one might expect that the benefits that have flowed from the adoption of the UCC will also flow from the adoption of the proposed framework. The adoption of uniform laws in general, and the UCC in particular, is said to produce a number of benefits, including the following:

- Increased certainty with regard to the legal treatment accorded to a transaction that involves more than one state;
- Simplification of transactions;
- Reduction of transaction costs and delays;
- Promotion of economic development by enabling business to be conducted across state lines in the framework of familiar and uniform laws; and

---

188. Phillips, *supra* note 187, at 64.

189. Allen R. Kamp, *Uptown Act: A History of the Uniform Commercial Code: 1940-49*, 51 SMU L. REV. 275, 277 (1998); Charles W. Mooney, *Introduction to the Uniform Commercial Code Annual Survey: Some Observations on the Past, Present, and Future of the U.C.C.*, 41 BUS. LAW. 1343, 1344-45 (1986).

190. Fred H. Miller, *Modernizing the UCC for the New Millennium: Introduction to a Collection on the New UCC*, 25 OKLA. CITY U. L. REV. 189, 190 n.2 (2000).

191. George A. Hisert, *Uniform Commercial Code: Does One Size Fit All?*, 28 LOY. L.A. L. REV. 219, 220-24 (1994); Phillips, *supra* note 187, at 62-63.

- Assisting individuals who regularly travel and move from one state to another and enter into family transactions or own property across state lines.[192]

Similar benefits have been cited in discussions of concerted coordination at the international level in the areas of taxation,[193] commerce,[194] and intellectual property rights.[195]

---

192. Daniel A. Gecker & Kevin R. Huennekens, *Waiving Goodbye to the UCC: A Proposal to Restrict the Continuing Erosion of Rights Under an Imperfect Code*, 28 LOY. L.A. L. REV. 175, 175 (1994); Hisert, *supra* note 191, at 219; Frederick H. Miller et al., *Introduction to Uniform Commercial Code Annual Survey: The Centennial of the National Conference of Commissioners on Uniform State Laws*, 46 BUS. LAW. 1449, 1451 (1991).

193. *See Tax Treaties: Hearing on Various Tax Treaties Before the S. Comm. on Foreign Relations*, 97th Cong. 7-8 (1982) (statement of John E. Chapoton, Assistant Secretary of the Treasury, Tax Policy) ("Among the major impediments to free capital and technology flows are the rules of national tax systems and their interaction with the systems of other countries. Tax treaties seek to eliminate, or at least mitigate, the impact of these impediments."); S. EXEC. REP. NO. 87-11, app. at 25 (1961) (statement of Edwin M. Martin, Assistant Secretary of State for Economic Affairs), *reprinted in* 4 LEGISLATIVE HISTORY OF UNITED STATES TAX CONVENTIONS at Canada 93B (Sidney I. Roberts ed., 1993).

> Estate tax treaties . . . help to bring about adjustments in two tax systems in such a way that movements of trade and investment between two countries may be facilitated and that conflicts in tax policy are substantially reduced or eliminated . . . . The elimination of double taxation in connection with the settlement in one country of estates in which nationals of another country have interests contributes also toward greater international understanding by removing a deterrent to the movement of individuals between countries.

Id.; COMM. ON FISCAL AFFAIRS, ORG. FOR ECON. CO-OPERATION & DEV., TAX TREATY OVERRIDES ¶ 1 (1990), *available at* LEXIS 90 TNI 7-13 ("(tax treaties) are an essential element in facilitating economic relations between States and encouraging flows of capital and labor . . . [t]hey limit and regulate the taxing jurisdiction of the States entering into them so as to ensure the orderly application of the domestic tax laws of what are often quite different systems" (footnote omitted)). *See also* Tsilly Dagan, *The Tax Treaties Myth*, 32 N.Y.U. J. INT'L L. & POL'Y 939, 983-86 (2000).

194. Paul B. Stephan, *The Futility of Unification and Harmonization in International Commercial Law*, 39 VA. J. INT'L L. 743, 743-48 (1999); Rod N. Andreason, *MCC-Marble Ceramic Center: The Parol Evidence Rule and Other Domestic Law Under the Convention on Contracts for the International Sale of Goods*, 1999 BYU L. REV. 351, 351 (1999); Robert Howse, *The Labour Conventions Doctrine in an Era of Global Interdependence: Rethinking the Constitutional Dimensions of Canada's External Economic Relations*, 16 CAN. BUS. L.J. 160, 178 (1990); Bradley J. Richards, *Contracts for the International Sale of Goods: Applicability of the United Nations Convention*, 69 IOWA L. REV. 209, 209 n.7 (1983).

195. Pauline Newman, *On Global Patent Cooperation*, 8 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 3, 8 (1997); Anthony D. Sabatelli & J.C. Rasser, *Impediments to Global Patent Law Harmonization*, 22 N. KY. L. REV. 579, 588-90, 594-96 (1995); Kevin Cuenot, *Perilous Potholes in the Path Toward Patent Law Harmonization*, 11 J.L. & POL'Y 101, 106 (1999); Vito J. DeBari, *International Harmonization of Patent Law: A Proposed Solution to the United States' First-to-File Debate*, 16 FORDHAM INT'L L.J. 687, 692-93 (1993).

In addition to producing direct benefits similar to those that have flowed from the adoption of the UCC, the proposed framework can be expected to produce collateral benefits. For example, a great deal of attention has recently been focused on international tax arbitrage, which occurs when taxpayers exploit the discontinuities between national tax systems in order to minimize the taxes paid to one or more countries.[196] Since international tax arbitrage thrives on external complexity, spontaneous tax coordination can be expected to reduce the opportunities for arbitrage involving the United States because it will diminish the level of external complexity in the U.S. international tax regime. Spontaneous tax coordination may also alleviate the impact of information asymmetries on less wealthy taxpayers. Information asymmetry exists when some taxpayers have better access to information than others.[197] As the level of complexity of the U.S. international tax regime has risen, taxpayers have increasingly found it necessary to seek the help of legal counsel when making cross-border investments.[198] Wealthy taxpayers naturally

---

196. *See, e.g.*, H.R. CONF. REP. NO. 105-220, at 573-74 (1997), *reprinted in* 1997 U.S.C.C.A.N. 1129, 1385-86 (addressing the exploitation of differences between the U.S. and Canadian treatment of U.S. limited liability companies to reduce U.S. and Canadian taxes under the income tax treaty concluded between the United States and Canada); Treaty Guidance Regarding Payments with Respect to Domestic Reverse Hybrid Entities, 66 Fed. Reg. 12,445 (proposed Feb. 27, 2001) (to be codified at Treas. Reg. § 1.894-1) (addressing the exploitation of differences between the U.S. and foreign characterization of entities to reduce U.S. and, possibly, foreign taxes); Notice 98-11, 1998-6 I.R.B. 18, *withdrawn by* Notice 98-35, 1998-27 I.R.B. 35 (addressing the exploitation of differences between the U.S. and foreign characterization of entities to reduce foreign tax without triggering current U.S. tax under Subpart F); Reuven S. Avi-Yonah, *Commentary*, 53 TAX L. REV. 167 (2000); H. David Rosenbloom, *International Tax Arbitrage and the "International Tax System,"* 53 TAX L. REV. 137 (2000).

197. John Azzi, *Tax Law Design and Drafting (Vol. 2): Comparing Income Tax Laws of the World*, 18 BERKELEY J. INT'L L. 196, 203 (2000). *See also* Fleming et al., *supra* note 27, at 315-16.

> A more fundamental problem with this 'self-inflicted wound' analysis, however, arises from its critical assumption that opportunities to earn foreign-source business income are freely and equally available to all U.S. residents. This is plainly not correct. There are barriers of distance, language, custom and unfamiliar and complex legal regimes that exclude numerous U.S. residents from the opportunity to earn foreign-source business income with anything approaching the foreign income earning facility of other U.S. residents.

Id. For a survey of the economics literature on the effects of asymmetric information, *see* John G. Riley, *Silver Signals: Twenty-Five Years of Screening and Signaling*, 39 J. ECON. LITERATURE 432 (2001).

198. Because this complexity stems from both internal and external sources, a taxpayer will need to retain more than one (and possibly several) tax attorneys in planning a cross-border transaction. The taxpayer will need to consult a domestic tax attorney to address the problems created by the internal complexity of the U.S. international tax regime, and then will need to have that domestic attorney consult with tax attorneys in each of the foreign countries that has a contact with the

have had a competitive advantage over less wealthy taxpayers in obtaining this help because they have "better access to expensive tax advice."[199] By decreasing external complexity, spontaneous tax coordination would reduce the need to seek such advice, and would thereby contribute to a leveling of the playing field between wealthy and less wealthy taxpayers when it comes to engaging in international business transactions.

To gauge the anticipated benefits of the proposed framework more precisely, however, its flexibility must be taken into account. As described above, the term "tax coordination" embraces an infinite number of degrees of adaptation between the extremes of unfettered tax competition and complete tax harmonization. It can be expected that the level of benefits produced by tax coordination will likewise vary, and that the difference between the benefits that are produced and the full measure of achievable benefits will be roughly proportionate to the difference between the coordination that is achieved and complete tax harmonization. In other words, it can be expected that the full measure of the benefits of coordination will be realized only if complete tax harmonization is achieved, and that to the extent the level of coordination achieved falls short of complete tax harmonization, the benefits attendant to coordination will be proportionately diminished.

Even so, this anticipated correlation does not necessarily militate in favor of pursuing complete tax harmonization and against pursuing more modest tax coordination; in fact, by striving for less than perfect uniformity in national tax laws, tax coordination may arguably produce even greater benefits than complete tax harmonization. Returning to the example of the UCC, some commentators have proposed federal codification of the UCC as a means of achieving the full measure of the benefits described above.[200] Opponents of federal codification have countered that the

---

transaction in order to address the problems created by the regime's external complexity.

199. Azzi, *supra* note 197, at 203.

200. *See, e.g.*, Donald B. King, *Major Problems with Article 2A: Unfairness, "Cutting Off" Consumer Defenses, Unfiled Interests, and Uneven Adoption*, 43 MERCER L. REV. 869, 885 (1992); Phillips, *supra* note 187, at 53-54. *See also* William J. Woodward, Jr., *Private Legislation in the United States: How the Uniform Commercial Code Becomes Law*, 72 TEMP. L. REV. 451, 452 n.5 (1999) (containing a list of contributions to this "long-running debate"). Along with nearly perfect uniformity, these commentators have also cited in support of federal codification (i) the greater authority of federal law, (ii) the ease with which federal law can be amended (as compared to amending the law of fifty individual states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands each time significant changes are proposed to the UCC), and (iii) the general impression that the UCC revision process is undemocratic (because it is the captive of business interests). Phillips, *supra* note 187, at 58-70; Woodward, *supra*, at 454, 465-66.

benefits of uniformity are outweighed by its costs.[201] They view the individual U.S. states as laboratories in which experiments in law can be undertaken.[202] If an experiment is successful, then the results can be replicated in other states. If, on the other hand, the experiment is unsuccessful, then the damage is limited to one state, in lieu of being inflicted on all of them, as would be the case if the experimentation occurred at the federal level. In short, opponents of federal codification of the UCC view less than perfect uniformity as a benefit in itself. They believe that "'rough' uniformity has resulted in greater efficiency without either eliminating the responsiveness of the law to changing local conditions or diminishing the well-recognized potential of the states as 'laboratories' in the federal system."[203] From this vantage point, tax coordination may produce greater benefits than complete tax harmonization.

To summarize, tax coordination can be expected to (i) simplify transactions with multinational contacts, (ii) increase the certainty of their legal treatment, and (iii) reduce the costs of undertaking them. The effect of these benefits should be to facilitate, or, at the very least, to reduce the tax impediments to, the cross-border flow of capital and labor. Tax coordination can also be expected to produce collateral benefits by reducing opportunities for international tax arbitrage and by ameliorating the negative effects of information asymmetries between taxpayers. Even the choice to pursue tax coordination rather than complete tax harmonization may be viewed as a benefit, because allowing for diversity among national tax systems will leave the way open to experimentation in international tax rules. Such experimentation will ultimately redound to the benefit of all countries that adopt a comparative approach to formulating domestic tax legislation.

---

201. Silber, *supra* note 187, at 456-57; Hisert, *supra* note 191, at 231-32; Giuseppe Tucci, *The Adequacy and Efficiency of American Commercial Law*, 29 LOY. L.A. L. REV. 1137, 1137-38 (1996). They have also countered the additional arguments mentioned in note 200. *See* Neil B. Cohen & Barry L. Zaretsky, *Drafting Commercial Law for the New Millennium: Will the Current Process Suffice?*, 26 LOY. L.A. L. REV. 551, 557-62 (1993) (assessing the alleged benefits of federal codification of the UCC and concluding that it is unclear that federal codification would be preferable to the current process); Fred H. Miller, *The Future of Uniform State Legislation in the Private Law Area*, 79 MINN. L. REV. 861, 861-69 (1995) (making the case for uniform legislation at the state level, and arguing that Congress is not up to the task of drafting legislation similar to the UCC); Larry E. Ribstein & Bruce H. Kobayashi, *An Economic Analysis of Uniform State Laws*, 25 J. LEGAL STUD. 131, 133, 187 (containing an economic analysis of uniform state laws, and concluding that "a more drastic federalization of the law in order to achieve efficient uniformity would be both unnecessary and perverse" and that, "[a]t best, federal law would not create more efficient laws, but simply a different set of winners and losers").

202. Ribstein & Kobayashi, *supra* note 201, at 140-41; Silber, *supra* note 187, at 456.

203. Silber, *supra* note 187, at 456. *See also* Hisert, *supra* note 191, at 219.

2. Costs: The Economic Perspective

Thus, viewing the matter from a legal perspective, there are a number of benefits that may be associated with engaging in spontaneous coordination. In the context of the UCC, these benefits are thought to be of such importance that lawyers generally do not debate the question whether to coordinate, but rather the desirable degree of coordination.[204] When shifting from a legal to an economic perspective, however, the terms of the debate change. As mentioned earlier, public-finance economists have for some time debated not the appropriate degree of tax coordination, but rather the propriety of engaging in any tax coordination at all.[205] Accordingly, in contrast to lawyers and legal academics, public-finance economists have focused more of their energy on analyzing the costs associated with engaging in tax coordination than on its benefits.

Contributions to this economic debate can be separated into the following two opposing groups: the Tiebout literature and the tax competition literature.[206] In the Tiebout literature, tax competition is considered to be welfare-enhancing and, therefore, beneficial, while tax coordination, which dampens tax competition, is considered to be harmful. In the tax competition literature, the model underlying the Tiebout literature is critically examined in an effort to reveal its inherent efficiency problems, and some form of tax coordination is normally advocated as a solution. For purposes of this Article, a discussion of the Tiebout literature will be used to highlight the costs associated with tax coordination, and a discussion of the tax competition literature will serve as a vehicle for exploring whether these costs outweigh the expected benefits of adopting STC/Comparative Law as a framework for reform.

a. The Tiebout Literature

The assertion in the Tiebout literature that tax competition is beneficial, and, conversely, that tax coordination is harmful, is based on two underlying premises. The first premise is that government is

---

204. *See, e.g.*, King, *supra* note 200, at 885 ("everyone agrees that commercial law . . . should be uniform"); Phillips, *supra* note 187, at 64 ("Admittedly, the problem of uniformity is largely a matter of degree. It is better to have a Uniform Commercial Code, even with . . . variations, operating in all fifty states, the District of Columbia, and United States territories, than to have instead fifty-odd more disparate versions of commercial law.").

205. *See supra* note 85. As indicated in the discussion of tax coordination in Part III.B. above, the alternative to tax coordination is a state of unfettered tax competition.

206. John Douglas Wilson, *Theories of Tax Competition*, 52 NAT'L TAX J. 269, 270-71 (1999).

a "Leviathan."[207] A Leviathan government is one that is composed of politicians and bureaucrats who wish to maximize the size of the public sector because of their ability to benefit from the budget that they control (by, for example, maintaining their employment, salary, and perquisites).[208] The Leviathan model of government is commonly associated with Geoffrey Brennan and James Buchanan.[209]

The second premise is that tax competition can restrain the growth of a Leviathan government. This premise is derived from the economic model set forth in Charles Tiebout's seminal article, *A Pure Theory of Local Expenditures*.[210] In this Article, Tiebout took issue with the notion that "a rather large portion of our national income [is] allocated in a 'non-optimal' way when compared with the private sector" because "no 'market type' solution exists to determine the level of expenditures on public goods."[211] Tiebout theorized that, at the local level, a market for public goods would be created if: (i) people are fully mobile; (ii) a large number of communities offer different, fixed packages of public services at different prices (i.e., levels of taxation) from which people can choose; and (iii) people are fully aware of the differences between these tax and service packages.[212] Under these circumstances, individuals would effectively be able to shop the market and relocate to the community that offers the tax and service package that most closely suits their respective

---

207. *See* Charles E. McLure, *Tax Competition: Is What's Good for the Private Goose Also Good for the Public Gander?*, 39 NAT'L TAX J. 341, 345 (1986); Wilson, *supra* note 206, at 296-97.

208. McLure, *supra* note 207, at 345; Wilson, *supra* note 206, at 296-97.

209. *See* GEOFFREY BRENNAN & JAMES M. BUCHANAN, THE POWER TO TAX: ANALYTICAL FOUNDATIONS OF A FISCAL CONSTITUTION 1-33 (1980). *See also* Avi-Yonah, *supra* note 82, at 1614 n.181; McLure, *supra* note 207, at 346 n.2.

210. Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416 (1956).

211. *Id.* at 416.

212. *Id.* at 418. Tiebout also assumes that the public services provided by each of the local governments result in no externalities (i.e., they have neither positive nor negative spillover effects on other communities). *Id.* at 419. An example of a negative externality is water pollution that affects downstream communities. *See* Hans-Werner Sinn, *Comments on: L. Bovenberg, "International Coordination of Tax Policies," in* THE REALITY OF INTERNATIONAL ECONOMIC POLICY COORDINATION 147, 148 (H.J. Blommestein ed., 1991). An example of a positive externality is locally-financed medical research that seeks to remedy a problem common to all communities (e.g., cancer). *See* McLure, *supra* note 207, at 343.

Tiebout further assumes that local governments levy only non-distorting benefits taxes. Tiebout, *supra* note 210, at 418-19. In the case of a benefits tax, the taxpayer is charged an amount equal to the cost of providing the public goods that he has consumed. WALLACE E. OATES, FISCAL FEDERALISM 128 (1972). Benefits taxes are non-distorting because "[t]here is no way the consumer can avoid payment for the public goods he consumes; he must pay directly the cost of the resources he absorbs in consuming the local public good." *Id.* at 130. The taxpayer, therefore, has no incentive for inefficient behavior, and the result is allocative efficiency. *Id.*

preferences.[213] By "voting with their feet," people in a Tiebout world would implicitly reveal their preferences for public goods, thereby promoting the efficient allocation of resources.[214] Tiebout therefore concluded that, for a "substantial portion of collective or public goods,"[215] there is in fact a conceptual solution to the problem of developing a "decentralized pricing system to determine optimally . . . levels of collective consumption."[216]

The notion that tax competition can restrain the growth of a Leviathan government is extrapolated from Tiebout's contention that the public sector is not entirely different from the private sector.[217] In the private sector, economic welfare is expected to suffer whenever competition is restrained—whether due to monopolistic practices, collusion within oligopolies, or other causes.[218] Economic welfare suffers because enterprises in non-competitive sectors feel no pressure "to provide the goods and services that consumers want [or] to produce them in the most efficient way, in order to minimize costs."[219] Managers and employees in non-competitive sectors resist attempts to increase competition because they are often able to appropriate to themselves a portion of the surplus that results when competition is restrained.[220] If, as Tiebout contends, the public sector is not entirely different from the private sector, then it can be expected that, absent competition from other governments, politicians and bureaucrats in a Leviathan government will lack the incentive to maximize the welfare of their constituents.[221] Instead, their incentive will be to maximize the size of the public sector for their own personal benefit. Tax competition serves as a check on the growth of a Leviathan government because it places downward pressure on tax rates, which, in turn, leads to downward pressure on governmental expenditures.[222] Politicians and bureaucrats are then forced to rethink expenditure policies with an eye toward (i) achieving greater efficiency by reducing costs and increasing productivity and

---

213. Tiebout, *supra* note 210, at 418. The greater the number of local governments to choose from, the closer the individual would be able to get to his own set of tax and service preferences. *Id.*

214. OATES, *supra* note 212, at 127.

215. Tiebout, *supra* note 210, at 424.

216. *Id.* (quoting Paul A. Samuelson, *The Pure Theory of Public Expenditures*, 36 REV. ECON. & STAT. 387, 388 (1954) (emphasis in original omitted)).

217. Wilson, *supra* note 206, at 298.

218. McLure, *supra* note 207, at 344.

219. *Id.*

220. *Id.* at 344-45.

221. *Id.* at 345.

222. Faria, *supra* note 89, at 229.

(ii) responding to the desires of their constituents rather than to their own self-interest.[223]

Consequently, the perceived benefit of tax competition is increased efficiency—both in terms of the amount of taxes collected and in terms of the allocation of that tax revenue among governmental expenditures. The idea that tax coordination is harmful follows naturally from this view of tax competition. Tax coordination has been likened to private sector "cartelization," which is a form of restraint on competition.[224] By restraining tax competition, tax coordination can be expected to cause economic welfare to suffer because it will reduce the efficiency gains that may be achieved under tax competition. Thus, from the perspective of the Tiebout literature, the cost of adopting STC/Comparative Law as a framework for reform would be inefficiency—both in terms of the amount of taxes collected and in terms of the allocation of that tax revenue among governmental expenditures.

b. The Tax Competition Literature

Because its contributors critically examine the conclusions reached in the Tiebout literature, a discussion of the tax competition literature is an apposite vehicle for exploring whether the anticipated efficiency costs of adopting the proposed framework would actually materialize and, if so, whether those costs would outweigh the framework's potential benefits. At the outset, it is worth noting that the contributors to the tax competition literature share a view of government that is fundamentally different than the one shared by contributors to the Tiebout literature.[225] The first premise underlying the assertion in the Tiebout literature that tax competition is beneficial is that government is a Leviathan composed of politicians and bureaucrats who wish to maximize the size of the public sector at the expense of their constituents.[226] In contrast, the economic models in the tax competition literature presuppose that government is akin to a benevolent dictator that acts to maximize the welfare of its residents.[227] Proceeding from this divergent view of government, the tax competition literature critically examines the assumptions underlying the conclusions reached in the Tiebout

---

223. McLure, *supra* note 207, at 345. *See also* Bovenberg, *supra* note 85, at 141-42; Faria, *supra* note 89, at 229.

224. "Cartelization is a process whereby independent industrial enterprises form a syndicate to secure a monopoly in a specific world market." Sijbren Cnossen, *Tax Harmonization Issues in the European Community*, 8 AM. J. TAX POL'Y 259, 259 (1990).

225. *See* TANZI, *supra* note 87, at 7.

226. *See supra* note 207 and accompanying text.

227. *See, e.g.*, George R. Zodrow & Peter Mieszkowski, *Pigou, Tiebout, Property Taxation, and the Underprovision of Local Public Goods*, 19 J. URB. ECON. 356, 359 (1986).

literature in "an attempt to understand the potential efficiency problems associated with competition for capital by local governments."[228] Wallace Oates has articulated the problem as follows:

> The result of tax competition may well be a tendency toward less than efficient levels of output of local public services. In an attempt to keep tax rates low to attract business investment, local officials may hold spending below those levels for which marginal benefits equal marginal costs, particularly for those programs that do not offer direct benefits to local business.[229]

In the 1980s, economists began to build formal models to test Oates' ideas.[230] In an early paper,[231] George Zodrow and Peter Mieszkowski formulated a basic tax competition model in which a national economy is composed of a large number of identical jurisdictions, with each resident owning an equal share of the land—a fixed factor—and of the national capital stock—a mobile factor. In a departure from the Tiebout model, which assumes that local governments impose only non-distorting benefits taxes,[232] Zodrow and Mieszkowski assumed that local public goods are financed either by a non-distorting lump-sum head tax, a distorting tax on mobile capital (in this case, a property tax), or some combination of the two. Based on these assumptions, Zodrow and Mieszkowski concluded that, if local jurisdictions choose to rely on distorting property taxes rather than on Tieboutian benefits taxes, tax competition will create efficiency problems in the form of an underprovision of public goods.[233] Zodrow and Mieszkowski attribute these efficiency problems to a "negative 'fiscal externality,'" namely the perception that raising property taxes will drive mobile capital out of the jurisdiction.[234]

Other early contributions to the tax competition literature build on this work. David Wildasin further developed the notion that "the inefficiency associated with tax competition can be understood as a kind of externality."[235] Like Zodrow and Mieszkowski, Wildasin attributed tax competition's efficiency problems to the perception that

---

228. Wilson, *supra* note 206, at 269.

229. OATES, *supra* note 212, at 143. *See* DIETMAR WELLISCH, THEORY OF PUBLIC FINANCE IN A FEDERAL STATE 18, n.12 (2000); Wilson, *supra* note 206, at 269.

230. Wilson, *supra* note 206, at 273.

231. *See* Zodrow & Mieszkowski, *supra* note 227.

232. *See supra* note 212.

233. Zodrow & Mieszkowski, *supra* note 227, at 368-69. *See also* John D. Wilson, *A Theory of Interregional Tax Competition*, 19 J. URB. ECON. 296, 308-09 (1986) (reaching a similar conclusion based on a more complicated model).

234. Zodrow & Mieszkowski, *supra* note 227, at 369 n.8.

235. David E. Wildasin, *Interjurisdictional Capital Mobility: Fiscal Externality and a Corrective Subsidy*, 25 J. URB. ECON. 193, 194 (1989).

an increase in the tax rate in one jurisdiction will cause mobile capital to flow out of that jurisdiction and into other, lower-tax jurisdictions.[236] The result of such an outflow of mobile capital would be an increase in the lower-tax jurisdictions' tax bases and, implicitly, their tax revenues.[237] Faced with this negative fiscal externality, each jurisdiction has "an incentive to undertax capital, or, equivalently, to underspend on local public goods."[238] Wildasin suggested corrective subsidies, presumably to be paid by a higher level of government, as a remedy for this problem.[239]

Sam Bucovetsky and John Douglas Wilson extended this analysis to a situation in which a tax on immobile labor is also available, relaxing the assumption in Zodrow and Mieszkowski's basic tax competition model that public goods are financed with a tax on mobile capital.[240] Yet, even relaxing this assumption, Bucovetsky and Wilson still reach the conclusion that tax competition would result in the underprovision of public goods.[241] They attribute this inefficiency to a fiscal externality similar to the one attendant to a tax on mobile capital: if a jurisdiction raises its tax rate on wage income, its labor supply will decline; this decline in the labor supply will lead to a decline in the jurisdiction's demand for capital; and this decline in the demand for capital will make more capital available for other jurisdictions and, ultimately, lead to a rise in their wages and labor supplies.[242]

To this day, academic interest and research in the area of tax competition "continues unabated."[243] Despite the evolving nature of the tax competition literature, it has become well-settled in this literature that tax competition has the deleterious effect of driving tax rates to the lowest common denominator, which results in the undertaxation of mobile capital, the overtaxation of immobile labor, and a general underprovision of public goods.[244] A possible solution to this efficiency problem that has often been considered in the literature "is for the tax authorities to engage in some kind of . . . tax

---

236. *Id.* at 194.

237. *Id.*

238. *Id.* at 196.

239. *Id.* at 196-97.

240. Sam Bucovetsky & John Douglas Wilson, *Tax Competition with Two Tax Instruments*, 21 REGIONAL SCI. & URB. ECON. 333, 333 (1991).

241. *Id.* at 334.

242. *Id.* at 342-43. *See also* Wilson, *supra* note 206, at 283.

243. Wilson, *supra* note 206, at 269. *See also* Wallace E. Oates, *Fiscal Competition or Harmonization? Some Reflections*, 54 NAT'L TAX J. 507 (2001).

244. *See* Clemens Fuest, *The Political Economy of Tax Coordination as a Bargaining Game Between Bureaucrats and Politicians*, 103 PUB. CHOICE 357, 357-58 (2000); Bernd Huber, *Tax Competition and Tax Coordination in an Optimum Income Tax Model*, 71 J. PUB. ECON. 441, 441-42 (1999); Michael Keen & Maurice Marchand, *Fiscal Competition and the Pattern of Public Spending*, 66 J. PUB. ECON. 33, 33-34 (1997).

coordination."[245] Because the conclusions reached in the tax competition literature about the relative costs and benefits of tax competition and tax coordination are quite the opposite of those reached in the Tiebout literature, they cast in doubt the notion that the cost of engaging in tax coordination is reduced efficiency.

Notably, even contributors to the Tiebout literature have acknowledged that the asserted benefits of tax competition may not extend to the international setting.[246] Extending the conclusions of the Tiebout literature beyond the domestic setting of a federal government such as the United States proves problematic because two of the key assumptions that underpin the Tiebout model do not hold true in the international setting. First, although it may be reasonable to assume that individuals are fully mobile "when it comes to the choice among suburban local governments grouped around a central place of employment," it is not quite so reasonable an assumption in the international setting, where individual mobility is much more limited due to immigration and emigration restrictions.[247] Similarly, although it may be reasonable to assume that sub-national jurisdictions will impose only benefits taxes, it is not quite so reasonable an assumption at the national level where "[t]axation in line with ability to pay is called for and distributional considerations cannot in practice be separated from the choice of public services."[248]

c. The Middle Road

The diametrically opposed conclusions of the Tiebout and tax competition literatures concerning the relative costs and benefits of tax competition and tax coordination emanate, at least in part, from

---

245. BO SANDEMANN RASMUSSEN, PARTIAL VS. GLOBAL COORDINATION OF CAPITAL INCOME TAX POLICIES 2 (Univ. of Aarhus, Dep't of Econ., Working Paper No. 2001-3, 2001). *See, e.g.*, Roger H. Gordon, *Can Capital Income Taxes Survive in Open Economies?*, 47 J. FIN. 1159 (1992); Assaf Razin & Efraim Sadka, *International Tax Competition and Gains from Tax Harmonization*, 37 ECON. LETTERS 69 (1991).

246. *See, e.g.*, INFLUENCE OF TAX DIFFERENTIALS ON INTERNATIONAL COMPETITIVENESS: PROCEEDINGS OF THE VIIITH MUNICH SYMPOSIUM ON INTERNATIONAL TAXATION 100-02 (1990) [hereinafter INFLUENCE OF TAX DIFFERENTIALS] (comments of Charles E. McLure, Jr.); Charles E. McLure, Jr., *International Considerations in United States Tax Reform*, *in id.* at 3, 20; Michael Rauscher, *Leviathan and Competition Among Jurisdictions: The Case of Benefit Taxation*, 44 J. URB. ECON. 59, 66 (1998).

247. Peggy B. Musgrave & Richard A. Musgrave, *Fiscal Coordination and Competition in an International Setting*, *in* INFLUENCE OF TAX DIFFERENTIALS, *supra* note 246, at 61, 64 (critiquing the application of the Tiebout model to the international context).

248. *Id. See generally* WELLISCH, *supra* note 229, at 20, 137-51.

their diametrically opposed views of government.[249] In the Tiebout literature, government is presumed to be a Leviathan that wishes to maximize the size of the public sector at the expense of its residents. In the tax competition literature, government is presumed to be akin to a benevolent dictator that wishes to maximize the welfare of its residents. Jeremy Edwards and Michael Keen have characterized these two viewpoints as "extreme cases of a more general—and presumably more plausible—formulation in which policymakers attach some value both to the welfare of their citizens and to the surplus that they are able to extract from the citizenry and put to their own uses."[250]

Using Zodrow and Mieszkowski's basic tax competition model, Edwards and Keen have examined the relative costs and benefits of tax competition and tax coordination where the policymakers in the country are assumed to be "neither wholly benevolent nor wholly self-serving."[251] Edwards and Keen did not set out unambiguously to resolve the conflict between the Tiebout and tax competition literatures; instead, their objective was "to identify relatively well-defined conditions upon which, in particular circumstances, the balance of truth between them turns."[252] Edwards and Keen ultimately concluded that

> the central issue can be reduced to the comparison between two numbers for which commentators might reasonably be asked to produce their best guesses. The first is the marginal excess burden of taxation (deadweight loss per dollar of revenue, at the margin); the second is the amount by which unproductive public expenditure would increase if the policy-maker were given an additional dollar of lump-sum revenue. Some degree of tax coordination is desirable if and only if the former exceeds the latter (the efficiency gain then being sufficient to outweigh the policy-maker's tendency to waste).[253]

Hence, as one might expect when moving away from extremes, there may be situations in which tax coordination will be desirable and others in which tax competition will be desirable.[254]

---

249. *See* Oates, *supra* note 243, at 510 ("The basic point here is that whether or not fiscal competition is a good thing depends in important ways on one's view of the public sector. . . .").

250. Jeremy Edwards & Michael Keen, *Tax Competition and Leviathan*, 40 EUR. ECON. REV. 113, 115 (1996).

251. *Id.* at 117.

252. *Id.* at 130.

253. *Id.* at 130-31 (citation omitted). Notwithstanding the ambiguity of Edwards and Keen's conclusion, Peter Birch Sørensen has indicated his belief that it is "unlikely" that conditions will be such that unfettered tax competition will prove to be desirable under this model. Peter Birch Sørensen, *The Case for International Tax Coordination Reconsidered*, 15 ECON. POL'Y 431, 433 (2000).

254. For a similarly ambiguous result, see Fuest, *supra* note 244, at 372-74, where the Edwards and Keen model is refined by reconceptualizing government as

Hewing to this more realistic middle road, several economists have advocated engaging in coordination in an effort to minimize tax-induced distortions in economic decision-making, while, at the same time, endeavoring to maintain the diversity of national tax systems to the extent possible.[255] This middle road represents a practical balancing of the costs and benefits of tax competition against those of tax coordination, with the scales apparently tipping somewhat in favor of tax coordination and away from tax competition. This practical balance between tax competition and tax coordination is entirely consistent with the description in this Article of the flexible manner in which the proposed framework for reforming the U.S. international tax regime is expected to operate in theory.[256]

V. THE PROPOSED FRAMEWORK IN PRACTICE

Having reviewed the operation of the proposed framework in theory and considered its costs and benefits, it will now be useful to consider the manner in which the proposed framework will operate in practice. As mentioned at the outset of this Article, the application of the proposed framework to the task of reforming the entire U.S. international tax regime is well beyond the scope of this Article. For this reason, a single, concrete example has been chosen for study here: the tax treatment of contributions made by domestic taxpayers to foreign non-governmental, nonprofit organizations that operate for the public benefit (NGOs).

This area was chosen for study because it suffers from both the excessive complexity and the failure to keep pace with a changing economy that generally plague the U.S. international tax regime. The U.S. rules governing the tax treatment of contributions made to foreign NGOs have been described as "ancient and bizarre."[257] The current rules date back to the 1930s, and they have not been changed since that time.[258] While these rules have remained static, the U.S. nonprofit sector[259] has grown dramatically. During the period from

---

being composed of politicians and bureaucrats with diverging interests (rather than as being a monolithic entity).

255. *See, e.g.*, Cnossen, *supra* note 224, at 278-79; HUFBAUER, *supra* note 18, at 16-17, 39-46; Musgrave & Musgrave, *supra* note 247, at 71-76. *See also supra* note 108.

256. *See supra* Part IV.B.

257. Harvey P. Dale, *Foreign Charities*, 48 TAX LAW. 655, 657 (1995).

258. *Id.* at 659-61.

259. The nonprofit sector is also sometimes referred to as the "voluntary," "independent," or "third" sector or as "civil society." *See* STEPHEN HASELER, THE POLITICAL CULTURE OF GIVING: AN INTERNATIONAL PERSPECTIVE 15 (Capital Research Center, Studies in Philanthropy No. 10, 1991); Lester M. Salamon et al., *Civil Society in Comparative Perspective*, *in* LESTER M. SALAMON ET AL., GLOBAL CIVIL SOCIETY:

1975 through 1995 alone, the number of charitable organizations filing information returns with the Internal Revenue Service more than doubled, and the assets and revenues reported by those organizations more than quadrupled—far outpacing real growth in gross domestic product of only seventy-four percent during the same period.[260]

The U.S. rules governing the tax treatment of contributions made to foreign NGOs also suffer from an onerous level of complexity.[261] As described more fully below, these rules contain geographic limitations of differing severity, with the level of severity depending both on the nature of the donor—whether individual, corporation, or estate or trust—and the tax that is being paid. In addition, a taxpayer's total deduction for charitable contributions may be subject to an overall limitation calculated as a percentage of the taxpayer's income, with the applicable percentage depending on the nature of the donor, the type of property being contributed, and the tax that is being paid.

Using the proposed framework, this Part will develop a proposal for reforming the rules governing the tax treatment of contributions made by U.S. persons to foreign NGOs. Because comparative law lies at the heart of the proposed framework, the comparative analysis described in Part IV(B) will be used to develop this reform proposal. This analysis will proceed in the following three phases: (i) the descriptive phase, (ii) the identification phase, and (iii) the explanatory phase.

In the descriptive phase, each country's rules governing the tax treatment of contributions made by domestic taxpayers to foreign NGOs will be described in their historical and cultural context. To obtain a moderately global perspective,[262] at least one legal system

---

DIMENSIONS OF THE NONPROFIT SECTOR 3, 3 (1999) [hereinafter GLOBAL CIVIL SOCIETY].

260. Alicia Meckstroth & Paul Arnsberger, *A 20-Year Review of the Nonprofit Sector 1975-1995*, STAT. INCOME BULL., Fall 1998, at 149, 151 fig. A, 153.

261. *See* Dale, *supra* note 257, at 696 ("It is impossible to justify the incredible complexity, inconsistency, and impenetrability of the relevant statutory, regulatory, and other authorities bearing on foreign charities. There can be no reason – and there is certainly no rhyme – to the current pattern.").

262. 2 TAX LAW DESIGN & DRAFTING, *supra* note 165, at xxv. Past attempts at categorizing the legal systems of the world into distinct families have been criticized for "trivializ[ing] the nuances and subtleties among legal families" and for "being largely Euro-American centric." Ugo Mattei, *Three Patterns of Law: Taxonomy and Change in the World's Legal Systems*, 45 AM. J. COMP. L. 5, 10 (1997); White, *supra* note 157, at 55. *See also* P.G. Monateri, *"Everybody's Talking": The Future of Comparative Law*, 21 HASTINGS INT'L & COMP. L. REV. 825, 839 (1998) ("the projects to draw a 'map' of legal systems and to build a common core of European and Western law are really biased, non-neutral political projects of governance supported by the use of the academic discipline of comparative law"); Mathias Reimann, *Stepping out of the European Shadow: Why Comparative Law in the United States Must Develop Its Own Agenda*, 46 AM. J. COMP. L. 637, 638-39 (1998) (generally describing the domination of Western

from each of the eight families of income tax laws[263] has been chosen for inclusion in this study. The countries included in the study, grouped according to legal family, are: (i) the United States, (ii) England and Wales, (iii) New Zealand, (iv) France, (v) Costa Rica, (vi) the Czech Republic, (vii) the Netherlands, (viii) Spain, and (ix) Japan.

In the identification phase, the rules described in the descriptive phase will be compared and contrasted in an effort to identify any similarities among them and differences between them. If possible, any trends in the adoption or abandonment of rules will also be identified.

In the explanatory phase, the results of the analysis performed in the identification phase will be employed as a framework for developing an appropriate rule for enactment by the United States—bearing in mind the considerations that normally influence the formulation of U.S. international tax policy. In developing this reform proposal, the potential of STC/Comparative Law both to coordinate the U.S. rules with those of other countries and to constrain the tendency of domestic tax policy considerations to produce internal complexity will be analyzed.

A. *Descriptive Phase*

1. The United States

a. Development of the Nonprofit Sector

The nonprofit sector has a deep-rooted history in the United States. The U.S. nonprofit sector dates back to "at least . . . the early 1800s, when Alexis de Tocqueville declared it to be the major factor explaining how America was able to avoid the dangers of tyranny and barbarism despite its highly individualistic culture."[264] The early diffusion of voluntary associations in the United States has been

---

European influence on U.S. comparative law). Because the development of an improved taxonomy for the income tax systems of the world is beyond the scope of this Article, Victor Thuronyi's taxonomy has been adopted for purposes of this study. *See infra* note 263.

263. As mentioned above, the income tax laws of the world have been divided into eight families: (i) American, (ii) British, (iii) French, (iv) Latin American, (v) transition countries (i.e., former socialist countries), (vi) Northern European, (vii) Southern European, and (viii) miscellaneous (e.g., Iran, Japan, and Korea). *See supra* note 48. I have re-ordered the list so that it will match the order in which the descriptions appear in the text below.

264. Lester M. Salamon, *The United States*, *in* LESTER M. SALAMON & HELMUT K. ANHEIER, DEFINING THE NONPROFIT SECTOR: A CROSS-NATIONAL ANALYSIS 280, 280 (Johns Hopkins Nonprofit Sector Series No. 4, 1997) [hereinafter DEFINING THE NONPROFIT SECTOR].

attributed to a combination of the colonists' hostility to centralized authority and to a spirit of individualism.[265] Voluntary associations met the colonists' needs by providing them "a way to confront common problems while still retaining a significant measure of individual initiative."[266] During the mid- to late-nineteenth century, a new set of common problems arose as immigrants began to arrive, and voluntary associations were once again formed to help these immigrants "acclimatize themselves to the American scene and cope with the challenges of urbanization and industrialization that were newly overtaking American life."[267] However, at the same time that Americans were forming voluntary associations to confront common problems, they were resisting the institutionalization of the nonprofit sector by "denying [associations] corporate status and restricting their ability to assemble self-perpetuating assets without a corresponding guarantee of their 'public' character and dedication to public purposes."[268]

It was not until the late nineteenth century that the concept of a nonprofit sector distinct from the public sector emerged in the United States.[269] During the period between the Civil War and the end of World War I, the nonprofit sector shed its image as a mere supplement to governmental action in meeting public needs and came to be viewed as the "superior vehicle" for meeting those needs.[270] This so-called "myth" of voluntarism, which created expectations that the nonprofit sector was unable to meet, was not broken until the 1930s when the New Deal social welfare programs were enacted.[271] With the advent of the war on poverty, the 1960s and 1970s witnessed a return to the partnership between the public and nonprofit sectors that had existed before the late nineteenth century.[272] This renewed partnership was accompanied by a dramatic expansion of the nonprofit sector.[273] By the late 1970s, the nonprofit sector was "delivering a larger share of *government-financed* human services than all levels of government combined,"[274] and public sector financial support "accounted for more than 30 percent of the overall operating revenue of nonprofit charitable service agencies; and in some fields, such as social services, it reached almost 50 percent."[275]

---

265. *Id.* at 282.
266. *Id.*
267. *Id.*
268. *Id.* at 285.
269. *Id.* at 285-88.
270. *Id.* at 286.
271. *Id.* at 288.
272. *Id.* at 288-89.
273. *Id.* at 289.
274. *Id.*
275. *Id.* at 305.

During the 1980s, the Reagan Administration "proposed to help the nonprofit sector chiefly by getting government out of its way."[276] This policy shift resulted in a significant drop in federal financial support for NGOs.[277] To make up for this drop in public sector financial support, NGOs have increasingly turned to "commercial sources for support, chiefly in the form of fees and charges for the sector's services."[278] A 1995 survey of the U.S. nonprofit sector indicates that service fees were the dominant source of revenue in that year, accounting for 56.6% of all revenue in the sector.[279] This survey also indicates that service fees accounted for sixty-two percent of the growth in nonprofit revenue from 1990 to 1995.[280] Nevertheless, the pendulum may now be swinging back in the direction of increased public sector support for NGOs. Since taking office, the Bush Administration has focused on expanding the role of religious NGOs in the provision of federally-financed social services, and has made this "faith-based initiative" a "core element" of its domestic agenda.[281]

b. NGO Tax Relief

In the United States, the activities of a variety of organizations are encouraged through a general exemption from the federal income tax.[282] Included in this rather eclectic list of exempt organizations are corporations, community chests, funds (including trusts),[283] and foundations that are organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals.[284] The term "charitable" in this list of exempt purposes is *not* limited in its scope by the other more specific purposes, and it has been broadly defined to include

---

276. *Id.*

277. *Id.* at 305-06.

278. *Id.* at 306.

279. S. Wojciech Sokolowski & Lester M. Salamon, *The United States, in* GLOBAL CIVIL SOCIETY, *supra* note 259, at 261, 272.

280. *Id.* at 278.

281. Amy Goldstein, *Hailing Faith's Influence: Bush Urges End to Bias Against the Religious*, WASH. POST, Feb. 2, 2001, at A2. *See also* Juliet Eilperin, *Faith-Based Initiative Wins House Approval*, WASH. POST, July 20, 2001, at A1; Dana Milbank & Thomas B. Edsall, *Faith Initiative May Be Revised: Criticism Surprises Administration*, WASH. POST, Mar. 12, 2001, at A1; Patti Mohr, *Bush Renews Action on Faith-Based Initiative*, 93 TAX NOTES 1131 (2001).

282. I.R.C. § 501(a) (2001) (incorporating by reference organizations listed in §§ 401(a) and 501(c)-(d)).

283. Fifth-Third Union Trust Co. v. Commissioner, 56 F.2d 767 (6th Cir. 1932).

284. I.R.C. § 501(c)(3) (2001).

> [r]elief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency.[285]

To be considered as organized exclusively for exempt purposes, a NGO's Articles of organization must limit its purposes to one or more exempt purposes and must not empower the NGO to engage in activities that are in themselves not in furtherance of one or more exempt purposes, other than as an insubstantial part of the NGO's activities.[286] In addition, the NGO's assets must be dedicated to one or more exempt purposes upon its dissolution, either by reason of a provision in its Articles of organization or by operation of law.[287] To be considered as operated exclusively for exempt purposes, a NGO must engage "primarily" in activities that accomplish one or more exempt purposes.[288] Furthermore, a NGO will not be considered as organized or operated exclusively for one or more exempt purposes "unless it serves a public rather than a private interest."[289] In addition to these organizational and operational requirements, a NGO must satisfy three further requirements: (i) no part of the NGO's net earnings may inure to the benefit of any private shareholder or individual, (ii) no substantial part of the NGO's activities may consist of lobbying, and (iii) the NGO may not participate or intervene in any political campaign on behalf of or in opposition to any candidate for public office.[290] NGOs that meet all of these requirements are often collectively referred to as "Section 501(c)(3)" or "charitable" organizations.

Charitable organizations have been exempted from the federal income tax since its enactment in 1913,[291] and are entitled to this exemption without regard to their place of organization—so long as they meet the requirements described above.[292] Nonetheless, to obtain the benefit of this exemption, domestic charitable organizations must generally apply to the Internal Revenue Service

---

285. Treas. Reg. § 1.501(c)(3)-1(d)(2) (2001).
286. Treas. Reg. § 1.501(c)(3)-1(b)(1)(i) (2001).
287. Treas. Reg. § 1.501(c)(3)-1(b)(4) (2001).
288. Treas. Reg. § 1.501(c)(3)-1(c)(1) (2001).
289. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) (2001). It has been further held that "an institution seeking tax-exempt status must . . . not be contrary to established public policy." Bob Jones Univ. v. United States, 461 U.S. 574, 586 (1983) (upholding the revocation of the tax-exempt status of an educational institution with a racially discriminatory admissions policy).
290. I.R.C. § 501(c)(3) (2001).
291. Revenue Act of 1913, ch. 16, § II(G)(a), 38 Stat. 166, 172 (1913).
292. Rev. Rul. 66-177, 1966-1 C.B. 132.

for recognition of their exempt status.[293] Even organizations that are not required to apply for recognition will sometimes submit an application in order to confirm their exempt status and obtain the imprimatur of the Internal Revenue Service.[294] Foreign charitable organizations are only required to apply for recognition of their exempt status if, from the date of their creation, they have received fifteen percent or more of their support from sources within the United States.[295]

Notwithstanding their general exemption from income tax, charitable organizations are liable to tax on their income from any trade or business that they regularly carry on and that is substantially unrelated to their exempt purposes.[296]

c. Donor Tax Relief

The United States also encourages the activities of charitable organizations by permitting donors to these organizations to claim a tax deduction for their contributions. Deductions for charitable contributions are allowable for federal income, estate, and gift tax purposes; however, the rules governing the deductibility of such contributions vary depending on the identity of the donor and the tax being paid. The discussion below will first examine the deductibility of charitable contributions for income tax purposes and then will examine their deductibility for estate and gift tax purposes.

(i) Income Tax Deduction

The extent to which charitable contributions are deductible for income tax purposes depends on the identity of the donor—whether individual, corporation, or estate or trust. The provisions governing the deductibility of charitable contributions made by individuals and corporations will be discussed first, followed by a discussion of the provisions governing the deductibility of charitable contributions made by estates and trusts.

---

293. *See* I.R.C. § 508 (2001); Treas. Reg. § 1.508-1(a) (2001). Churches and charitable organizations with gross receipts below a specified threshold are exempted from this requirement. I.R.C. § 508(c) (2001); Treas. Reg. § 1.508-1(a)(3) (2001).

294. INTERNAL REVENUE SERV., INSTRUCTIONS FOR FORM 1024: APPLICATION FOR RECOGNITION OF EXEMPTION UNDER SECTION 501(A), at 1 (Sept. 1998).

295. Treas. Reg. § 1.508-1(a)(2)(vi) (2001); I.R.C. § 4948(b) (2001); Treas. Reg. § 53.4948-1(b) (2001). *But cf.* Dale, *supra* note 257, at 690 (indicating that the Internal Revenue Service has on occasion narrowly read this provision, but arguing that this reading is flawed).

296. I.R.C. §§ 511-14 (2001).

(a) Individuals and Corporations

The income tax deduction for charitable contributions was first introduced for individuals in 1917,[297] and was later extended to corporations in 1935.[298] At present, Section 170(a) of the Internal Revenue Code provides, with respect to both individuals and corporations, that "[t]here shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year."[299] A deduction is allowed whether the contribution is made in cash or in kind. In the case of in-kind contributions, the general rule is that the deduction is equal to the fair market value of the contributed property, but, under certain circumstances, the deduction may be reduced.[300] The total deduction for charitable contributions made during the taxable year cannot exceed a specified percentage of the donor's income. The specified percentage is either fifty percent, thirty percent, twenty percent, ten percent, or some combination thereof, depending on the nature of the donee organization, the nature of the contributed property, and whether the donor is an individual or corporation.[301]

For purposes of Section 170, the term "charitable contribution" is defined, in pertinent part, as a contribution or gift to a corporation, trust, community chest, fund, or foundation that meets the following four requirements:

1. The donee organization must be created or organized in the United States or a U.S. possession, or under the law of the United States, any state, the District of Columbia, or a U.S. possession;
2. The donee organization must be organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals;
3. No part of the net earnings of the donee organization may inure to the benefit of any private shareholder or individual; and

297. War Revenue Act of 1917, ch. 63, § 1201(2), 40 Stat. 300, 330 (1917).
298. Revenue Act of 1935, ch. 829, § 102, 49 Stat. 1014, 1016 (1935).
299. I.R.C. § 170(a)(1) (2001).
300. *See* Treas. Reg. § 1.170A-1(c)(1) (2001); I.R.C. § 170(e)(1) (2001). A donor of appreciated property will generally not be liable for income tax on the gain inherent in the property. Palmer v. Commissioner, 62 T.C. 684, 693-95 (1974); *Cf.* Rev. Rul. 60-370, 1960-2 C.B. 203.
301. *See* I.R.C. § 170(b) (2001).

4. The donee organization must not be disqualified from tax exempt status under Internal Revenue Code § 501(c)(3) by reason of lobbying or political campaign activities.[302]

In the case of contributions to foreign NGOs, the first of these four requirements is determinative—no income tax deduction is currently allowed for a contribution by either an individual or a corporation that is made directly to a foreign NGO. This place-of-organization limitation was introduced into the Internal Revenue Code in 1935 in connection with the extension of the deduction for charitable contributions to corporations.[303] It was not, however, until 1938 that this limitation was also applied to contributions made by individuals;[304] thus, from 1917 until 1938, there was no geographic limitation on the income tax deduction for charitable contributions made by individuals.[305] Extending the place-of-organization limitation to individuals was justified by Congress on the following grounds:

> The bill provides that the deduction allowed to taxpayers other than corporations be also restricted to contributions made to domestic institutions. The exemption from taxation of money or property devoted to charitable and other purposes is based upon the theory that the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare. The United States derives no such benefit from gifts to foreign institutions, and the proposed limitation is consistent with the above theory. If the recipient, however, is a domestic organization the fact that some portion of its funds is used in other countries for charitable and other purposes (such as missionary and educational purposes) will not affect the deductibility of the gift.[306]

In addition to this place-of-organization limitation, charitable contributions made by corporations—but *not* those made by individuals—are subject to a place-of-use limitation: "[a] contribution or gift by a corporation to a trust, chest, fund, or foundation shall be deductible by reason of this paragraph only if it is to be used within the United States or any of its possessions."[307] Whether intentionally or through careless drafting, incorporated charitable organizations are noticeably absent from the enumeration of donee organizations

---

302. I.R.C. § 170(c)(2) (2001).

303. *See supra* note 87 and accompanying text.

304. Revenue Act of 1938, ch. 289, § 23(o), 52 Stat. 447, 463 (1938).

305. Joannie Chang et al., *Cross-Border Charitable Giving*, 31 U.S.F. L. REV. 563, 568 (1997).

306. H.R. REP. NO. 75-1860, at 19-20 (1938), *reprinted in* 1939-1 C.B. (pt. 2) 728, 742. This justification for extending the place-of-organization restriction to individuals has been criticized as the product of "bad history," "bad philosophy," and "bad logic." Dale, *supra* note 257, at 660-61.

307. I.R.C. § 170(c)(2) (2001) (flush language).

that are subject to this limitation.[308] In fact, the Internal Revenue Service has confirmed that the place-of-use limitation does not apply to donations made to incorporated charitable organizations, thereby allowing corporate donors to make deductible contributions to these organizations without regard to the foreign or domestic use of their funds.[309]

In practice, these geographic limitations have made it more difficult, but not impossible, for U.S. individuals and corporations to obtain tax relief for contributions that are meant to benefit foreign NGOs. To circumvent the place-of-organization limitation, U.S. individuals and corporations need only make their contributions to a domestic charitable organization, which can then pass those contributions on to the intended foreign recipient. The contribution to the domestic intermediary NGO will be respected so long as it is not "earmarked" for the foreign NGO, which means that the domestic intermediary must exercise discretion and control as to the use of the contributions that it receives.[310] Conversely, the place-of-organization restriction will not be circumvented if the contribution merely comes "to rest momentarily in a qualifying domestic organization."[311] If the tax-exempt status of the foreign NGO has not been recognized by the Internal Revenue Service, then the domestic intermediary must, in order to protect its own tax-exempt status, either (i) make a determination that the foreign NGO satisfies the requirements for tax-exempt status, or (ii) ensure that the grant to the foreign NGO is expended for exempt purposes.[312] This practice of funneling contributions to foreign NGOs through domestic intermediaries has spawned the widespread creation of "friends of" organizations, such as "American Friends of the Vienna State Opera" and "American Friends of the London Business School."[313] A cursory review of the list of tax-exempt organizations published by the Internal Revenue Service reveals more than five hundred "American Friends of" organizations, most, if not all, of which appear to be associated with foreign NGOs.[314] To circumvent the place-of-use

308. Dale, *supra* note 257, at 672.

309. Rev. Rul. 69-80, 1969-1 C.B. 65.

310. Rev. Rul. 75-65, 1975-1 C.B. 79; Rev. Rul. 63-252, 1963-2 C.B. 101, *amplified by* Rev. Rul. 66-79, 1966-1 C.B. 48.

311. Rev. Rul. 63-252, 1963-2 C.B. 101, 104, *amplified by* Rev. Rul. 66-79, 1966-1 C.B. 48.

312. *See* I.R.C. § 4942(g)(1)(A) (2001); I.R.C. § 4945(d)(4) (2001); Rev. Proc. 92-94, 1992-2 C.B. 507; Rev. Rul. 68-489, 1968-2 C.B. 210; Dale, *supra* note 257, at 680-85.

313. INTERNAL REVENUE SERV., PUB. NO. 78, 1 CUMULATIVE LIST OF ORGANIZATIONS DESCRIBED IN SECTION 170(C) OF THE INTERNAL REVENUE CODE OF 1986, at 89 (2000).

314. *Id.* at 86-90.

limitation, corporate donors need only to restrict their contributions to incorporated charitable organizations.[315]

In addition to being easy to circumvent, these geographic limitations have been superseded by provisions in income tax treaties concluded by the United States with Canada,[316] Israel,[317] and Mexico.[318] The U.S.-Canada Income Tax Treaty allows U.S. persons a deduction for contributions made to Canadian organizations that are exempt from tax in Canada and that could qualify to receive deductible contributions if they were resident in the United States.[319] The amount of the deduction is subject to the percentage limitations that are generally applicable under U.S. law,[320] but with reference to Canadian source income rather than worldwide taxable income.[321] The U.S.-Israel Income Tax Treaty also allows U.S. persons a deduction for contributions made to Israeli organizations that are exempt from tax in Israel and that could qualify to receive deductible contributions if they were resident in the United States.[322] The

---

315. Dale, *supra* note 257, at 673.

316. Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital, Sept. 26, 1980, U.S.-Can., art. XXI, para. 5, S. EXEC. DOC. T, 96-2, at 17-18 (1980) [hereinafter U.S.-Canada Income Tax Treaty].

317. Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Nov. 20, 1975, U.S.-Isr., Protocol, art. X, S. EXEC. DOC. M, 96-2, at 4 (1980) [hereinafter U.S.-Israel Income Tax Treaty].

318. Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Sept. 18, 1992, U.S.-Mex., art. 22, para. 2, S. TREATY DOC. NO. 103-7, at 43-44 (1993) [hereinafter U.S.-Mexico Income Tax Treaty].

319. U.S.-Canada Income Tax Treaty, *supra* note 316, art. XXI, para. 5, S. EXEC. DOC. T, 96-2, at 17. In an exchange of notes, the United States and Canada each agreed to review the other country's procedures and requirements for determining eligibility to receive tax-deductible charitable contributions, "with a view to avoiding duplicate application by such organizations to the administering agencies of both [countries]." *Id.*; Exchange of Notes, S. EXEC. DOC. T, 96-2, at 28-30. Following this review, the United States and Canada reached an agreement in 1999 under which one country's determination as to exempt status will be recognized by the other. Notice 99-47, 1999-2 C.B. 391. Accordingly, a Canadian NGO that is recognized by Revenue Canada as a Canadian registered charity is now eligible to receive tax-deductible contributions from U.S. persons without applying to the Internal Revenue Service for recognition of its tax-exempt status. Nevertheless, Canadian NGOs may be required to furnish the U.S. Internal Revenue Service information to establish the appropriate percentage limitation applicable under U.S. law (as incorporated in the U.S.-Canada Income Tax Treaty). *Id. See also infra* note 321 and accompanying text.

320. *See supra* note 301 and accompanying text.

321. U.S.-Canada Income Tax Treaty, *supra* note 316, art. XXI, para. 5, S. EXEC. DOC. T, 96-2, at 18. Nevertheless, in the case of contributions made to a college or university at which the U.S. person (or a member of his family) was enrolled, the percentage limitations are applied by reference to worldwide income (and not by reference to Canadian source income). *Id.*

322. U.S.-Israel Income Tax Treaty, *supra* note 317, Protocol, art. X, S. EXEC. DOC. M, 96-2, at 4. The United States and Israel have also exchanged notes in which

amount of the deduction is limited to twenty-five percent of the U.S. person's Israeli source income.[323] The U.S.-Mexico Income Tax Treaty allows U.S. persons a deduction for contributions made to Mexican organizations that qualify under Article 70-B of the Mexican Income Tax Law (i.e., those that are exempt from tax in Mexico and are eligible to receive contributions that are deductible for Mexican tax purposes).[324] The amount of the deduction is subject to the percentage limitations that are generally applicable under U.S. law,[325] but with reference to Mexican source income rather than worldwide taxable income.[326]

It is unlikely, however, that similar provisions will be included in future income tax treaties, because the U.S. Senate has voiced concern about using the treaty process to grant a deduction that is otherwise disallowed under domestic law.[327] Indeed, the Senate Foreign Relations Committee has indicated that it will seriously consider recommending a reservation on any future provisions permitting U.S. persons to deduct charitable contributions made to foreign NGOs.[328] Prior to making this statement, the Senate had, in fact, entered a reservation to such a provision in an income tax treaty concluded with Brazil.[329] After this statement was made, in the course of treaty negotiations, Barbados requested a provision allowing U.S. persons a deduction for charitable contributions made to Barbadian NGOs. In response, the U.S. negotiating delegation conveyed its inability to agree to such a provision, but indicated that

---

they each agreed to review the other country's procedures and requirements for determining eligibility to receive tax-deductible charitable contributions, "with a view to avoiding duplicate application by such organizations to the administering agencies of both [countries]." *Id.*; Exchange of Notes, S. EXEC. DOC. M, 96-2, at 8-10. The United States and Israel have yet to reach an agreement similar to the one that the United States reached with Canada. *See supra* note 319.

323. U.S.-Israel Income Tax Treaty, *supra* note 317, Protocol, art. X, S. EXEC. DOC. M, 96-2, at 4.

324. U.S.-Mexico Income Tax Treaty, *supra* note 318, art. 22, para. 2, S. TREATY DOC. NO. 103-7, at 43-44; *id.*, Protocol, para. 17(b), S. TREATY DOC. NO. 103-7, at 66-67.

325. *See supra* note 301 and accompanying text.

326. U.S.-Mexico Income Tax Treaty, *supra* note 318, art. 22, para. 2, S. TREATY DOC. NO. 103-7, at 44.

327. *Tax Conventions with: The Russian Federation,* S. TREATY DOC. 102-39; *United Mexican States,* S. TREATY DOC. 103-7; *The Czech Republic,* S. TREATY DOC. 103-17; *The Slovak Republic,* S. TREATY DOC. 103-18; *and The Netherlands,* S. TREATY DOC. 103-6. *Protocols Amending Tax Conventions with: Israel,* S. TREATY DOC. 103-16; *The Netherlands,* S. TREATY DOC. 103-19; *and Barbados,* S. TREATY DOC. 102-41; *Hearing Before S. Comm. on Foreign Rel.,* 103d Cong. 44 (1994) (statement of Senator Sarbanes); S. EXEC. REP. NO. 98-22, at 8-9 (1984); S. EXEC. REP. NO. 97-29, at 6 (1981).

328. S. EXEC. REP. NO. 98-22, at 9 (1984); S. EXEC. REP. NO. 97-29, at 6 (1981).

329. S. EXEC. REP. NO. 90-5, at 3 (1968), *reprinted in* 3 LEGISLATIVE HISTORY OF UNITED STATES TAX CONVENTIONS at Brazil 159 (Sidney I. Roberts ed., 1993). This treaty never entered into force. *See* Gordon et al., *supra* note 13; 1 Tax Treaties (CCH) ¶ 1567.01 (1990).

it would be prepared to re-open discussions if U.S. policy were to change in the future.[330]

(b) Estates and Trusts

Estates and trusts were first granted a deduction for charitable contributions in 1919,[331] approximately two years after the deduction was granted to individuals. The deductibility of charitable contributions made by estates and complex trusts is currently governed by Section 642(c)(1) of the Internal Revenue Code.[332] Section 642(c)(1) allows a deduction for amounts "paid for a purpose specified in section 170(c);" which is the provision governing the deductibility of contributions made by individuals and corporations. Section 642(c)(1) then goes on specifically to provide that the place-of-organization limitation in Section 170(c)(2)(A) does *not* apply to contributions made by estates and trusts.[333] In addition, unlike the deduction allowed to individuals and corporations, the amount of an estate's or complex trust's charitable contribution deduction is *not* limited to a percentage of its taxable income.[334]

(ii) Estate and Gift Tax Deduction

Individuals, but not corporations or trusts, are also subject to the federal estate and gift taxes.[335] Charitable gifts, bequests, and

---

330. Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Dec. 31, 1984, U.S.-Barb., S. TREATY DOC. NO. 99-3, at 23-25 (1985).

331. Revenue Act of 1918, ch. 18, § 219(b), 40 Stat. 1057, 1071 (1919).

332. This discussion is confined to the deductibility of charitable contributions made by estates and complex trusts because simple trusts are not permitted to make charitable contributions. *See* Treas. Reg. § 1.651(a)-1(b) (2001) (to qualify as a simple trust, the governing instrument of the trust *cannot* permit any amounts to "be paid, permanently set aside, or used in the taxable year for the charitable, etc., purposes specified in section 642(c)").

333. I.R.C. § 642(c)(1) (2001) (allowing a deduction for amounts "paid for a purpose specified in section 170(c) (determined without regard to section 170(c)(2)(A))"); Treas. Reg. § 1.642(c)-1(a)(2) (2001).

> [A]n amount paid to a corporation, trust, or community chest, fund, or foundation otherwise described in section 170(c)(2) shall be considered paid for a purpose specified in section 170(c) even though the corporation, trust, or community chest, fund, or foundation is not created or organized in the United States, any State, the District of Columbia, or any possession of the United States.

Id. If, however, the trust has "unrelated business income," then the rules of § 170 become applicable and the geographic limitations should apply to the trust's charitable contribution deduction. Dale, *supra* note 257, at 678-79.

334. Alan S. Acker, *Income Taxation of Trusts and Estates*, Tax Mgmt. (BNA) No. 852, § IV(B)(2)(k), at A-40 (2001); Dale, *supra* note 257, at 675.

335. I.R.C. § 2001 (2001); I.R.C. § 2501 (2001). The estate tax is currently set to be fully phased out by January 1, 2010. Economic Growth and Tax Relief

devises—whether in cash or in kind—are deductible for estate and gift tax purposes, and there are no percentage limitations on the deduction similar to those applicable for income tax purposes.[336] Furthermore, neither the estate nor the gift tax imposes a geographic limitation on the deductibility of charitable contributions made by U.S. individuals.[337] This lack of a geographic limitation opens the door to the possibility that an individual's contribution may be deductible for estate and gift tax purposes, but not for income tax purposes.[338]

2. England and Wales

a. Development of the Nonprofit Sector

In England and Wales, both charitable endeavors and the provision of social services "were the province of the Church" prior to the Reformation.[339] The enactment in 1601 of the Statute of Elizabeth and the Poor Law marked the beginning of the formalization and secularization of philanthropy in England and Wales.[340] From this time until the early twentieth century, the provision of education and the delivery of social services were dominated by the nonprofit sector, with the public sector only filling

---

Reconciliation Act of 2001, Pub. L. No. 107-16, § 501(a), 115 Stat. 38, 69 (2001). Even after the estate tax has been phased out, however, the gift tax will continue to apply to individuals. *See* H.R. CONF. REP. NO. 107-84, at 191-92 (2001).

336. *Compare* I.R.C. § 2055(a)(2)-(3) (2001), *and* I.R.C. § 2522(a)(2) (2001), *with* I.R.C. § 170(b) (2001).

337. Treas. Reg. § 20.2055-1(a) (2001) ("The deduction is not limited, in the case of estates of citizens or residents of the United States, to transfers to domestic corporations or associations, or to trustees for use within the United States."); Treas. Reg. § 25.2522(a)-1(a) (2001) ("The deduction is not limited to gifts for use within the United States, or to gifts to or for the use of domestic corporations, trusts, community chests, funds, or foundations, or fraternal societies, orders, or associations operating under the lodge system."). There are, however, geographic limitations on the estate and gift tax deductions for charitable contributions made by nonresident aliens. *See* I.R.C. § 2106(a)(2)(A)(ii)-(iii) (2001); I.R.C. § 2522(b)(2)-(3) (2001).

338. *See* Dale, *supra* note 257, at 668. This inconsistency not only increases the complexity of the rules applicable to charitable contributions made to foreign NGOs, but also (i) undermines the "government burden" rationale for imposing geographic limitations on the income tax charitable contribution deduction and (ii) gives individuals the rather odd incentive to forego inter vivos charitable contributions to foreign NGOs in favor of testamentary contributions to these organizations. *See* Chang, *supra* note 305, at 579.

339. JAMES DOUGLAS & PETER WRIGHT, ENGLISH CHARITIES, PART I: LEGAL DEFINITION, TAXATION AND REGULATION 4 (Yale University, Institution for Social and Policy Studies, Program on Nonprofit Organizations, Working Paper No. 15, 1980); Jeremy Kendall & Martin Knapp, *The United Kingdom*, *in* DEFINING THE NONPROFIT SECTOR, *supra* note 264, at 249, 262 (Johns Hopkins Nonprofit Sector Series No. 4, 1997).

340. Kendall & Knapp, *supra* note 339, at 250.

in the gaps.[341] In particular, during the eighteenth and nineteenth centuries, the pressures resulting from industrialization created an increasing demand for social services—a demand that the public sector was either reluctant or unable to fulfill—leaving "the way open for the development of formal voluntary organizations at [the] local and national level."[342] The organizations created to fill this demand not only provided social services, but also played the role of advocate, "highlighting new needs and bringing old injustices to public attention."[343]

With the advent of the welfare state in the early part of the twentieth century, the roles played by the nonprofit and public sectors reversed.[344] This reversal was due, at least in part, to the failure of the nonprofit sector to meet "rapidly growing social and individual needs."[345] Once the foundations of the welfare state had been laid in England and Wales in the 1940s, "the public sector came to dominate the funding and provision of education, health, social welfare, and income maintenance services."[346] NGOs served as agents in furnishing these now public sector services, and also continued to provide services in areas that remained outside of the public sector domain, such as child care and care of the elderly.[347] During the 1960s and 1970s, the limitations on the ability of the public sector to provide services, "a desire to combat newly emerging problems, such as urban decay and racial tension, and enhanced expectations from the general public prompted public sector bodies . . . to fund community-based groups and consumer and service-user organizations to a much greater extent than before."[348] During the 1980s and into the 1990s, the focus shifted further toward privatization (i.e., the replacement "of public sector activity with nongovernmental activity wherever and whenever" possible), and the provision of social services by the public sector came to be "defined in residual terms for the first time since the early 1940s."[349]

---

341. *Id.* at 262-63; DOUGLAS & WRIGHT, *supra* note 339, at 4.
342. Kendall & Knapp, *supra* note 339, at 250.
343. *Id.*
344. DOUGLAS & WRIGHT, *supra* note 339, at 4; Kendall & Knapp, *supra* note 339, at 263-64.
345. Kendall & Knapp, *supra* note 339, at 263.
346. *Id.* at 252.
347. *Id.* at 264.
348. *Id.* at 252-53.
349. *Id.* at 267.

b. NGO Tax Relief

In England and Wales, all charities must register with the Charity Commission unless specifically exempted.[350] For this purpose, a charity is defined as "any institution, corporate or not, which is established for charitable purposes and is subject to the control of the High Court in the exercise of the court's jurisdiction with respect to charities."[351] The Charities Act leaves the task of defining the term "charitable purpose" to the courts,[352] because "it was decided that the benefit of flexibility to reflect social changes outweighed that of definitional certainty."[353]

The starting point for any judicial discussion of what constitutes a charitable purpose is the preamble to the Statute of Elizabeth, which lists the following as charitable purposes: the relief of aged, impotent, and poor persons; the maintenance of sick and maimed soldiers and mariners, schools of learning, free schools, and scholars in universities; the repair of bridges, ports, havens, causeways, churches, sea-banks, and highways; the education and preferment of orphans; the relief, stock, or maintenance for houses of correction; the marriages of poor maids; the supportation, aid and help of young tradesmen, handicraftmen, and persons decayed; the relief or redemption of prisoners or captives; and the aid or ease of any poor inhabitants concerning payments of fifteens, setting out of soldiers, and other taxes.[354] The concept of charity embodied in the Statute of Elizabeth has evolved over time, and its list of charitable purposes has been refined substantially by the courts.[355] The "most influential"[356] judicial refinement of the list of charitable purposes in

---

350. Charities Act, 1993, c. 10, §§ 1, 3 (Eng.), *reprinted in* 5 HALSBURY'S STATUTES OF ENGLAND AND WALES 945-46, 947-49 (4th ed. 1998).

351. *Id.* § 96(1), *reprinted in* 5 HALSBURY'S STATUTES OF ENGLAND AND WALES 1051 (4th ed. 1998).

352. *See id.* § 97(1), *reprinted in* 5 HALSBURY'S STATUTES OF ENGLAND AND WALES 1052-53 (4th ed. 1998) ("'charitable purposes' means purposes which are exclusively charitable according to the law of England and Wales").

353. Alison Paines, *England and Wales*, *in* INTERNATIONAL CHARITABLE GIVING: LAWS AND TAXATION at England and Wales–1, England and Wales–1 (Carole Shelbourn George ed., 1999) [hereinafter INTERNATIONAL CHARITABLE GIVING]. *See also* John J. Dilger, *United Kingdom*, *in* INT'L FISCAL ASS'N, 84a CAHIERS DE DROIT FISCAL INTERNATIONAL: TAXATION OF NON-PROFIT ORGANIZATIONS 753, 759 (1999) [hereinafter TAXATION OF NON-PROFIT ORGANIZATIONS].

354. An Act to Redress the Mis-employment of Lands, Goods and Stocks of Money Heretofore Given to Certain Charitable Uses, 43 Eliz., c. 4, preamble (1601) (Eng.).

355. Paines, *supra* note 353, at England and Wales–2.

356. *Id. See also* Dilger, *supra* note 353, at 759; Paul Bater, *United Kingdom*, *in* INT'L BUREAU OF FISCAL DOCUMENTATION, THE TAX TREATMENT OF CROSS-BORDER DONATIONS: INCLUDING THE TAX STATUS OF CHARITIES AND FOUNDATIONS at United

the Statute of Elizabeth is that of Lord Macnaghten in *Special Commissioners of Income Tax v. Pemsel*: "'Charity' in its legal sense comprises four principal divisions: trusts for the relief of poverty, trusts for the advancement of education, trusts for the advancement of religion, and trusts for other purposes benficial [sic] to the community not falling under any of the preceding heads."[357] Within these four general categories, the concept of charity has continued to evolve and embrace new activities that reflect changes in the broader society.[358] In fact, the Charity Commission has recently undertaken a review of the register of charities for the purpose of determining both whether organizations that are currently on the register conform with the modern concept of charity (and, therefore, should remain on the register) and whether organizations that are not currently on the register should be included on it (because the concept of charity has, over time, come to embrace the purposes for which they were created).[359]

Any time that an organization appears on the register of charities, it is "for all purposes other than rectification of the register . . . conclusively presumed to be . . . a charity."[360] Thus, entry on the register of charities automatically entitles an organization to claim any exemptions from taxation to which charities may be entitled.[361] In England and Wales, charities do not benefit from a general exemption from income tax; instead, charities are liable to tax unless they can establish a claim to a particular exemption from tax collected under one of the several income tax schedules.[362] Currently, charities are exempt from income tax with respect to their real property income, dividends, interest, royalties, annuities, income from lotteries, and income derived from donations.[363] Charities are

---

Kingdom–1, United Kingdom–1 (Paul Bater ed., 2001) [hereinafter CROSS-BORDER DONATIONS].

357. Special Comm'rs of Income Tax v. Pemsel, [1891] A.C. 531, 583, 3 T.C. 53, 96 (H.L. 1891) (Eng.).

358. Dilger, *supra* note 353, at 760 (indicating that "research into terrorism, coupled with the dissemination of the research has been held charitable by the charity commissioners"); Paines, *supra* note 353, at England and Wales–3 (indicating that, in 1999, "the Charity Commission announced the recognition of two new charitable purposes, the promotion of urban regeneration and the relief of unemployment").

359. CHARITY COMM'N FOR ENG. & WALES, THE REVIEW OF THE REGISTER OF CHARITIES pt. 1, ¶ 2 (2001), *available at* http://www.charitycommission.gov.uk/publications/rr1.asp.

360. Charities Act, 1993, c. 10, § 4(1) (Eng.), *reprinted in* 5 HALSBURY'S STATUTES OF ENGLAND AND WALES 950 (4th ed. 1998).

361. Paines, *supra* note 353, at England and Wales-4.

362. Brighton College v. Marriott, [1926] A.C. 192, 10 T.C. 213 (H.L. 1925) (Eng.).

363. Income and Corporation Taxes Act, 1988, c. 1, §§ 9(4), 505-06 (Eng.), *reprinted in* 44 HALSBURY'S STATUTES OF ENGLAND AND WALES 39, 815-20 (4th ed.

also exempt from income tax with respect to profits from trades that they carry on, but only if those profits are applied solely to the purposes of the charity *and* either (i) the trade is exercised in the course of carrying out the charity's primary purpose or (ii) the work in connection with the trade is mainly carried out by the charity's beneficiaries.[364] Additionally, charities are exempt from capital gains tax so long as the capital gain "is applicable and applied for charitable purposes."[365] Nevertheless, eligibility for these exemptions may be limited if the charity incurs "non-qualifying expenditures," which include certain payments to non-U.K. organizations and any investments or loans that are not included in a list of "qualifying" investments and loans.[366]

Even though the statutory language is broad enough to embrace them, it was held in *The Camille and Henry Dreyfus Foundation, Inc. v. Commissioners of Inland Revenue* that foreign NGOs are *not* eligible to claim the benefit of these tax exemptions.[367] The decision in that case was primarily reached on the basis of a reading of the statutory language in the context of the relevant sections of the Income Tax Act 1918. This geographical limitation was, however, also explained as a vestige of history—the exemption dates back to 1799, "at which date there was no question of taxing, therefore none of exempting, non-resident foreigners."[368] It is also worth noting that the decision in the Court of Appeal eschewed reliance on an argument put forth by the Crown that the tax exemption was intended to apply only to charities that benefit the public in the United Kingdom:

> Counsel for the Crown propounded the proposition that the reason for the exemption afforded to charities by Section 37 was that the Legislature thought fit to forego the tax on income devoted to charitable

---

1996). *See also* Paines, *supra* note 353, at England and Wales–10; Bater, *supra* note 356, at United Kingdom–6.

364. Income and Corporation Taxes Act, 1988, c. 1, § 505(1)(e) (Eng.), *reprinted in* 44 HALSBURY'S STATUTES OF ENGLAND AND WALES 816 (4th ed. 1996).

365. Taxation of Chargeable Gains Act, 1992, c. 12, § 256(1) (Eng.), *reprinted in* 43 HALSBURY'S STATUTES OF ENGLAND AND WALES 656 (4th ed. 1996).

366. Income and Corporation Taxes Act, 1988, c. 1, §§ 505(3), 506, sch. 20 (Eng.), *reprinted in* 44 HALSBURY'S STATUTES OF ENGLAND AND WALES 816, 819-20 (4th ed. 1996).

367. The Camille and Henry Dreyfus Found., Inc. v. Comm'rs of Inland Revenue, [1956] A.C. 39, 36 T.C. 126 (H.L. 1955) (Eng.); Comm'rs of Inland Revenue v. Gull, 4 All E.R. 290, 21 T.C. 374 (H.L. 1937) (Eng.). *See also* 23 HALSBURY'S LAWS OF ENGLAND ¶ 1164 n.1 (Lord Hailsham of St. Marylebone ed., 1991). Nevertheless, England and Wales have by treaty extended the benefit of these exemptions to charities that are tax residents of the Republic of Ireland. Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, June 2, 1976, U.K.-Ir., arts. 12-13, (1976) SI 1976/2151 (Eng.); *id.* Protocol, art. 2, (1976) SI 1976/2152 (Eng.); *id.* Protocol, art. 2, (1998) SI 1998/3151 (Eng.).

368. *The Camille and Henry Dreyfus Found., Inc.*, 36 T.C. at 153 (opinion of Jenkins, L.J.). *See also id.* at 156 (opinion of Hodson, L.J.).

> purposes because income spent on those purposes is spent for the benefit of the public, just as the tax is levied for the benefit of the public, so that the tax foregone goes to increase the benefit derived by the public from the furtherance of the charitable purpose. To this they added the further proposition that the relevant public for the purposes both of tax and of charity is the public in the United Kingdom, and invited the conclusion that the exemption afforded by Section 37 should be held limited to charities in the United Kingdom. . . . But the authorities do not bear this out, for . . . there are many instances in which purposes have been recognised as charitable notwithstanding that they were to be pursued wholly abroad.[369]

c. Donor Tax Relief

England and Wales have experienced a decline in charitable giving over the past two decades.[370] In an effort "to create a dynamic environment in which more people will be encouraged to give and in which charities can do more to raise funds," the British Treasury has explored a number of options for spurring charitable giving.[371] This review of tax incentives for charitable giving culminated in the enactment of a new form of tax relief, as well as a number of changes to existing forms of tax relief, in the Finance Act 2000.

As a result of the changes made by the Finance Act 2000, there are now generally three types of income tax relief available for contributions made to registered charities. First, taxpayers who are employed can make contributions through a payroll giving scheme established by their employer.[372] Contributions made through payroll giving schemes are treated as deductible expenses that offset the taxpayer's income.[373] In the case of contributions made on or after April 6, 2000 and before April 6, 2003, a supplement equal to ten percent of the taxpayer's contribution is paid by the government to the charity.[374] The Finance Act 2000 repealed the maximum

369. *Id.* at 150 (opinion of Jenkins, L.J.); *See also id.* at 135-36 (opinion of Sir Raymond Evershed, M.R.).

370. HM TREASURY, REVIEW OF CHARITY TAXATION: CONSULTATION DOCUMENT ¶ 1.7 (1999), *available at* http://www.inlandrevenue.gov.uk/consult/rct.pdf.

371. *Id.* ¶ 1.11.

372. Income and Corporation Taxes Act, 1988, c. 1, § 202 (Eng.), *reprinted in* 44 HALSBURY'S STATUTES OF ENGLAND AND WALES 342-43 (4th ed. 1996), *amended by* Finance Act, 2000, c. 17, § 38 (Eng.), *reprinted in* [E] HALSBURY'S STATUTES OF ENGLAND AND WALES: CURRENT STATUTES SERVICE at 43 Taxation 777-78 (4th ed. 2001).

373. Income and Corporation Taxes Act, 1988, c. 1, § 202(2) (Eng.), *reprinted in* 44 HALSBURY'S STATUTES OF ENGLAND AND WALES 342 (4th ed. 1996).

374. Finance Act, 2000, c. 17, § 38(1)-(4) (Eng.), *reprinted in* [E] HALSBURY'S STATUTES OF ENGLAND AND WALES: CURRENT STATUTES SERVICE at 43 Taxation 777-78 (4th ed. 2001).

annual limit on contributions that can be made through a payroll giving scheme.[375]

Second, under the "gift aid" scheme, an individual's contribution to charity, of whatever amount,[376] is treated as having been made after deduction of basic rate tax (at a rate of twenty-two percent), which the charity may be able to recover from the Inland Revenue.[377] A higher rate (i.e., forty percent) taxpayer is entitled to additional tax relief, which is effected by means of an increase in her basic rate bracket.[378] To illustrate the operation of both the basic and additional tax relief under the gift aid scheme, assume that a taxpayer has income of GBP 300,000 and makes a charitable contribution of GBP 78,000.[379] The taxpayer provides the charity with a declaration stating that the contribution is being made under the gift aid scheme and that she has paid an amount of income and/or capital gains tax equal to the amount that the charity can reclaim from the Inland Revenue. The contribution is treated as having been made by the taxpayer after deduction of basic rate tax; thus, the contribution is grossed-up to GBP 100,000—the amount that, after paying tax at the basic rate of twenty-two percent, produces a contribution of GBP 78,000—and the charity is entitled to recover the difference between the grossed-up and the actual contribution—in this example, GBP 22,000, which is GBP 100,000 - GBP 78,000—from the Inland Revenue. Because the taxpayer is a higher rate taxpayer,

---

375. *Id.* § 38(5)(b), *reprinted in* [E] HALSBURY'S STATUTES OF ENGLAND AND WALES: CURRENT STATUTES SERVICE at 43 Taxation 778 (4th ed. 2001) (repealing the maximum annual limit in Section 202(7) of the Income and Corporation Taxes Act 1988).

376. The GBP 250 threshold for a donation to qualify for the gift aid scheme has been eliminated. Finance Act, 2000, c. 17, § 39(1), -(3)(a) (Eng.), *reprinted in* [E] HALSBURY'S STATUTES OF ENGLAND AND WALES: CURRENT STATUTES SERVICE at 43 Taxation 778 (4th ed. 2001) (repealing Section 25(2)(g) of the Finance Act 1990).

377. Finance Act, 2001, c. 9, § 50 (Eng.), *reprinted in* [E] HALSBURY'S STATUTES OF ENGLAND AND WALES: CURRENT STATUTES SERVICE at 43 Taxation 1679 (4th ed. 2001). There are three tax rate brackets in England and Wales: the starting, basic, and higher rates. For 2001-02, the starting rate, which applies to income up to GBP 1,880, is 10%. *Id.* §§ 50-51, *reprinted in* [E] HALSBURY'S STATUTES OF ENGLAND AND WALES: CURRENT STATUTES SERVICE at 43 Taxation 1679-80 (4th ed. 2001). The basic rate, which applies to income from GBP 1,881 to GBP 29,400, is 22%, and the higher rate, which applies to income over GBP 29,400, is 40%. *Id.* § 50, *reprinted in* [E] HALSBURY'S STATUTES OF ENGLAND AND WALES: CURRENT STATUTES SERVICE at 43 Taxation 1679 (4th ed. 2001); Income and Corporation Taxes Act, 1988, c. 1, § 1(2)(a)(b) (Eng.), *reprinted in* 44 HALSBURY'S STATUTES OF ENGLAND AND WALES 29 (4th ed. 1996 & Supp. 2001).

378. Finance Act, 1990, c. 29, § 25 (Eng.), *reprinted in* 43 HALSBURY'S STATUTES OF ENGLAND AND WALES 264-66 (4th ed. 1996), *amended by* Finance Act, 2000, c. 17, § 39 (Eng.), *reprinted in* [E] HALSBURY'S STATUTES OF ENGLAND AND WALES: CURRENT STATUTES SERVICE at 43 Taxation 778-82 (4th ed. 2001).

379. This example is taken from Rebecca Shaw, *Getting Britain Giving: In Practice*, 2 PRIVATE CLIENT BUS. 115, 117 (2001), *available at* WESTLAW P.C.B. 2001, 2, 115-20.

she is entitled to additional relief, which takes the form of an increase in her basic rate bracket. The taxpayer's basic rate bracket, which normally ends at GBP 29,400,[380] is increased by the grossed-up amount of the charitable contribution—here, GBP 100,000. As a result, rather than ending at GBP 29,400, the taxpayer's basic rate bracket in this example will end at GBP 129,400, which is GBP 29,400 + GBP 100,000. This increase in the basic rate bracket affords the taxpayer additional relief equal to eighteen percent of the grossed-up contribution, which is the difference between the higher rate (i.e., forty percent) that would normally apply to this amount of income and the basic rate (i.e., twenty-two percent) that is actually applied to it. In this example, the additional relief equals GBP 18,000 (18% x GBP 100,000). Corporations may also make contributions under the gift aid scheme; however, their contributions are made on a gross basis and tax relief is claimed when their profits are calculated for corporation tax purposes.[381]

Finally, both individuals and corporations are now afforded tax relief for contributions of "qualifying investments" to charity.[382] For this purpose, a contribution includes not only an outright gift of the qualifying investment, but also the sale of the qualifying investment to a charity for less than fair market value.[383] Qualifying investments include: (i) shares or securities that are listed or dealt in on a recognized stock exchange, (ii) units in an authorized unit trust, (iii) shares in an open-ended investment company, and (iv) interests in offshore funds.[384] If a taxpayer makes a contribution of a qualifying investment, or sells the qualifying investment to a charity for less than fair market value, then the taxpayer is entitled to a deduction equal to (i) the fair market value of the property plus incidental costs, (ii) less any consideration received, and (iii) less the value of any benefits received by the donor as a result of making the contribution.[385]

In addition to receiving the various forms of income tax relief described above, taxpayers in England and Wales who make

---

380. Income and Corporation Taxes Act, 1988, c. 1, § 1(2)(b) (Eng.), *reprinted in* 44 HALSBURY'S STATUTES OF ENGLAND AND WALES 29 (4th ed. 1996 & Supp. 2001).

381. *Id.* § 339, *reprinted in* 44 HALSBURY'S STATUTES OF ENGLAND AND WALES 551-53 (4th ed. 1996), *amended by* Finance Act, 2000, c. 17, § 40 (Eng.), *reprinted in* [E] HALSBURY'S STATUTES OF ENGLAND AND WALES: CURRENT STATUTES SERVICE at 43 Taxation 782-84 (4th ed. 2001).

382. Finance Act, 2000, c. 17, § 43 (Eng.), *reprinted in* [E] HALSBURY'S STATUTES OF ENGLAND AND WALES: CURRENT STATUTES SERVICE at 43 Taxation 785-87 (4th ed. 2001).

383. *Id.* (see new § 587B(1)).

384. *Id.* (see new § 587B(9)).

385. *Id.* (see new § 587B(4)-(7)).

charitable contributions are also exempt from capital gains tax[386] and are generally exempt from inheritance tax[387] on their contributions to registered charities. Taxpayers in England and Wales will not, however, benefit from any of this tax relief if their contributions are made to foreign NGOs.[388] To obtain tax relief for contributions made to foreign NGOs, taxpayers in England and Wales must route those contributions through English or Welsh registered charities, which are permitted to make grants to foreign NGOs so long as they take "such steps as may be reasonable in the circumstances to ensure that the payment will be applied for charitable purposes."[389]

3. New Zealand[390]

a. NGO Tax Relief

In New Zealand, a NGO can take the form of an incorporated society, a trust, or an unincorporated association.[391] Whether a NGO will be subject to income tax in New Zealand depends both on the type of income that it earns (i.e., business or non-business) and on the geographic scope of its charitable purposes.[392]

A NGO is generally exempt from tax with respect to its non-business income.[393] This exemption applies whether the NGO was formed as a trust for charitable purposes or as a society or institution established exclusively for charitable purposes and not carried on for the private pecuniary profit of any individual.[394] The availability of

---

386. Taxation of Chargeable Gains Act, 1992, c. 12, § 257 (Eng.), *reprinted in* 43 HALSBURY'S STATUTES OF ENGLAND AND WALES 656-57 (4th ed. 1996).

387. Inheritance Tax Act, 1984, c. 51, § 23 (Eng.), *reprinted in* 42 HALSBURY'S STATUTES OF ENGLAND AND WALES 696-97 (4th ed. 1996).

388. *See supra* note 367 and accompanying text.

389. Income and Corporation Taxes Act, 1988, c. 1, § 506(3) (Eng.), *reprinted in* 44 HALSBURY'S STATUTES OF ENGLAND AND WALES 819 (4th ed. 1996). *See also* Bater, *supra* note 356, at United Kingdom–7 to –8.

390. A description of the development of the nonprofit sector in New Zealand has been omitted due to a lack of sources exploring this topic. This lack of source material is likely explained by the fact that study of the nonprofit sector, both here and abroad, is still in its infancy.

391. Kevin J. Holmes, *New Zealand*, *in* CROSS-BORDER DONATIONS, *supra* note 356, at New Zealand-1, New Zealand-1.

392. NGOs also benefit from a partial exemption from fringe benefits tax, which is "a substitute for the income tax that would be paid by an employee on remuneration received in monetary form." POLICY ADVICE DIV., INLAND REVENUE DEP'T, TAX AND CHARITIES: A GOVERNMENT DISCUSSION DOCUMENT ON TAXATION ISSUES RELATING TO CHARITIES AND NON-PROFIT BODIES ¶ 12.7 (2001), *available at* http://www.taxpolicy.ird.govt.nz/publications/files/tax&charitiesdd.pdf [hereinafter INLAND REVENUE, TAX AND CHARITIES]. *See* Income Tax Act, 1994, § CI 1(m) (N.Z.).

393. Income Tax Act, 1994, § CB 4(1)(c) (N.Z.); Holmes, *supra* note 391, at New Zealand–4, –9.

394. Income Tax Act, 1994, § CB 4(1)(c) (N.Z.).

the exemption for non-business income is not affected by the geographic scope of the NGO's charitable purposes.[395]

A NGO is also exempt from tax with respect to its business income, but only if its charitable purposes are limited to New Zealand.[396] If the NGO's charitable purposes are not so limited, then its business income may be apportioned between charitable purposes within and without New Zealand, and only the income allocated to charitable purposes within New Zealand will benefit from the exemption.[397] In a recent report on the tax treatment of charities, the New Zealand Inland Revenue Department proposed to abolish the current regime for taxing the business income of NGOs.[398] In its place, the Inland Revenue proposed a regime under which all of a NGO's business income would be taxed, subject to an unlimited deduction for distributions made for charitable purposes.[399]

For purposes of the current tax exemptions, the Income Tax Act of 1994 has defined the term "charitable purpose" as including "every charitable purpose, whether it relates to the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community."[400] This definition of charitable purpose has its roots in the English Statute of Elizabeth,[401] and reflects "the four 'heads' of charity"[402] articulated by the English Lord Macnaghten in *Special Commissioners of Income Tax v. Pemsel*.[403] In its recent report on the tax treatment of charities, the Inland Revenue explored the possibility of altering or replacing the current definition of "charitable purpose" in an effort (i) to update it "in light of the needs of New Zealand in the 21st century," because the definition is based on law that is up to four hundred years old, and (ii) to ensure that the income tax exemption for NGOs is not "too widely available," so as to prevent the exemption from being used by some businesses to gain advantages over others.[404]

In New Zealand, NGOs are not required to register either with the Inland Revenue or with a body generally charged with the regulation of charitable organizations (like the English Charity Commission) as a prerequisite to obtaining the benefits of the income

395. Holmes, *supra* note 391, at New Zealand–9.
396. Income Tax Act, 1994, § CB 4(1)(e) (N.Z.).
397. *Id.*
398. INLAND REVENUE, TAX AND CHARITIES, *supra* note 392, ¶ 9.8.
399. *Id.*
400. Income Tax Act, 1994, § OB 1 (N.Z.).
401. *See supra* note 354 and accompanying text.
402. INLAND REVENUE, TAX AND CHARITIES, *supra* note 392, ¶¶ 3.4, 3.9.
403. Special Comm'rs of Income Tax v. Pemsel, [1891] A.C. 531, 583, 3 T.C. 53, 96 (H.L. 1891) (Eng.).
404. INLAND REVENUE, TAX AND CHARITIES, *supra* note 392, ¶¶ 4.1-.4, 5.1-.25.

tax exemptions described above.[405] Nonetheless, in practice, most NGOs "will submit their founding documents to Inland Revenue for its view as to whether or not the entity is charitable at law"; however, the views of the Inland Revenue are not binding (unless a binding ruling is obtained) because "[w]hether an entity is a charity for tax purposes is ultimately a matter for the courts."[406] Thus, it is possible for a NGO to benefit from the various income tax exemptions in New Zealand without the government being aware of the claim to the exemptions.[407] In its recent report on the tax treatment of charities, the Inland Revenue sought to rectify this situation by recommending that each NGO be required "to officially notify the government, by means of a set procedure, that it considers itself to be a charity for tax purposes."[408]

b. Donor Tax Relief

New Zealand also affords tax relief to donors of contributions made to NGOs. Individuals are permitted a "rebate," or tax credit, for cash contributions of at least NZD 5, provided that the contribution is made to a "donee organization."[409] A NGO will qualify as a donee organization if: (i) it is a domestic NGO; (ii) it is not carried on for the private pecuniary profit of any individual; and (iii) its funds are, in the opinion of the Inland Revenue, applied wholly or principally to charitable, benevolent, philanthropic, or cultural purposes within New Zealand.[410] The amount of the rebate afforded to individual donors is equal to the lesser of one-third of the charitable contributions made during the year or NZD 500.[411] In its recent report on the tax treatment of charities, the Inland Revenue proposed to increase the maximum rebate from NZD 500 to NZD 600.[412] The Inland Revenue also considered, but rejected, the possibility of (i) permitting donations of property other than money to qualify for the rebate and (ii) introducing a payroll giving scheme similar to the one that currently exists in England and Wales.[413]

---

405. *Id.* ¶¶ 1.5, 6.3.

406. *Id.* ¶ 6.3; David Simcock, *New Zealand*, *in* INTERNATIONAL CHARITABLE GIVING, *supra* note 353, at New Zealand–1, –4.

407. INLAND REVENUE, TAX AND CHARITIES, *supra* note 392, ¶ 6.3.

408. *Id.* ¶ 8.4.

409. Income Tax Act, 1994, § KC 5(1)(aa) (N.Z.); INLAND REVENUE, TAX AND CHARITIES, *supra* note 392, ¶ 6.4.

410. Income Tax Act, 1994, § KC 5(1)(aa) (N.Z.); INLAND REVENUE, TAX AND CHARITIES, *supra* note 392, ¶ 6.4. In practice, many NGOs seek confirmation of this "donee" status from the Inland Revenue. INLAND REVENUE, TAX AND CHARITIES, *supra* note 392, ¶ 6.4.

411. Income Tax Act, 1994, § KC 5(2) (N.Z.).

412. INLAND REVENUE, TAX AND CHARITIES, *supra* note 392, ¶ 11.8.

413. *Id.* ¶¶ 11.9-.10. See *supra* text accompanying notes 372-75 for a description of the payroll giving scheme in England and Wales.

Despite being generally confined to domestic NGOs with domestic charitable purposes, donee status has been extended by the New Zealand Parliament to a number of specifically-identified foreign NGOs (e.g., UNICEF and Amnesty International) and domestic NGOs with foreign charitable purposes.[414] Both foreign NGOs and domestic NGOs with foreign charitable purposes must, therefore, "seek and obtain specific legislative approval" of their donee status.[415] For a NGO with foreign charitable purposes to obtain legislative approval of its donee status, the funds obtained by the NGO must "be applied towards either: the relief of poverty, hunger, sickness or ravages of war or natural disaster; or the economy of developing countries (recognised as such by the United Nations); or raising the educational standards of a developing country."[416] NGOs with foreign charitable purposes that have been "formed for the principal purpose of fostering or administering any religion, cult or political creed" have, however, been refused donee status.[417] Donee status is restricted in this manner because the tax relief afforded to donors is viewed by New Zealand as a governmental expenditure that "should be consistent with [its] overseas aid programme."[418] In its recent report on the tax treatment of charities, the Inland Revenue proposed to standardize the tax treatment of NGOs with foreign charitable purposes by making both their income tax exemption and their donee status depend on a grant of specific legislative approval from the New Zealand Parliament.[419]

In addition to being afforded income tax relief, individuals are exempted from gift duty, which is imposed at graduated rates ranging from five percent to twenty-five percent, on their contributions to NGOs.[420] There is no geographic limitation on the exemption from gift duty.[421]

---

414. Income Tax Act, 1994, § KC 5(1) (N.Z.). Most recently the Cry for the World Foundation New Zealand Humanitarian Aid Fund was added to the list of specifically-identified NGOs afforded donee status. Taxation (Taxpayer Assessment and Miscellaneous Provisions) Act, 2001, § 140 (N.Z.). In a bill introduced in the New Zealand Parliament in December 2001, donee status would also be extended to the Akha Rescue Ministry Charitable Trust. Taxation (Relief, Refunds, and Miscellaneous Provisions) Bill, 2001, § 40 (N.Z.); Adrian J. Sawyer, *New Zealand's December Tax Bill Contains a Potpourri of Changes*, 25 TAX NOTES INT'L 259 (2002).

415. INLAND REVENUE, TAX AND CHARITIES, *supra* note 392, ¶ 6.5. *See also id.* ¶ 10.1.

416. *Id.* ¶ 10.3.

417. *Id.* ¶ 10.4.

418. *Id.* ¶ 10.2.

419. *Id.* ¶¶ 10.6-.10. *See supra* text accompanying notes 391-396.

420. Estate and Gift Duties Act, 1968, § 73(1) (N.Z.). Note that the estate duty has been abolished. Holmes, *supra* note 391, at New Zealand–6.

421. Holmes, *supra* note 391, at New Zealand–9.

Corporations, other than closely-held corporations,[422] that make cash contributions to donee organizations are entitled to deduct the amount of their gifts in calculating their taxable income.[423] The amount of the deduction is subject to two limitations: (i) a per-donee limitation and (ii) an overall limitation. Under the per-donee limitation, the deduction for contributions to any one donee organization cannot exceed in a given year the greater of one percent of the corporation's net income or NZD 4,000.[424] Under the overall limitation, the total deduction for all contributions to donee organizations made during the year cannot exceed the greater of five percent of the corporation's net income or NZD 1,000.[425] In its recent report on the tax treatment of charities, the Inland Revenue proposed to simplify the limitations on corporate charitable contributions by removing the per-donee limitation as well as the NZD 1,000 portion of the overall limitation, thereby allowing corporate contributions up to five percent of the corporation's net income.[426] The Inland Revenue also proposed to extend the deduction for charitable contributions to closely-held corporations that are listed on a recognized stock exchange.[427] As was the case with the tax relief afforded to individuals, the Inland Revenue considered, but rejected, the possibility of allowing a deduction for contributions of property other than money.[428]

4. France

a. Development of the Nonprofit Sector

The nonprofit sector in France dates back to the origins of the French nation in the fifth century.[429] During the early Middle Ages, French society was based on feudalism and the central state was weak.[430] While feudal lords provided protection to the peasantry, it was the Catholic Church that tended to social concerns.[431] The Church owned a great deal of real estate and collected a tithe from the populace; this property was considered the "patrimony of the

---

422. A closely-held corporation is one that is controlled by five or fewer persons. *See* Income Tax Act, 1994, § OB 1 (N.Z.).

423. *Id.* § DJ 4.

424. *Id.* § DJ 4(a).

425. *Id.* § DJ 4(b).

426. INLAND REVENUE, TAX AND CHARITIES, *supra* note 392, ¶¶ 11.14-.15.

427. *Id.* ¶ 11.16.

428. *Id.* ¶ 11.13.

429. EDITH ARCHAMBAULT, THE NONPROFIT SECTOR IN FRANCE 20 (Johns Hopkins Nonprofit Sector Series No. 3, 1997).

430. *Id.*

431. *Id.*

poor," who were entered on a list—the *matricule*—and were entitled "to receive one third of the gifts to the parishes."[432]

During the climax of the Middle Ages, power shifted from the feudal lords to the king, and although the Church continued to play an important role, a rise in giving by the king, nobles, and the newly-created bourgeoisie marked the beginning of the secularization of French philanthropy.[433] During the late Middle Ages, the political and economic turmoil of The Hundred Years War and the decimation caused by the Plague were accompanied by a "rise of extreme poverty and [a] decrease of resources . . . for charitable organizations."[434] This caused the Church to try to "shift the responsibility of some charities to laymen and to the emerging central state."[435] During the Renaissance, the secularization of charities continued as "King François I created a 'great agency for the poor'" and "the royal chaplains were commissioned to control every hospital in the kingdom."[436] By the time of the Enlightenment, the nonprofit sector had become very active, and there were "early examples of nearly every kind of nonprofit organization[ ]."[437]

The French Revolution dealt a severe blow to this flourishing nonprofit sector. In 1791, as part of the effort to wipe out all vestiges of the *ancien régime*, the *Décret d'Allarde* suppressed the medieval guilds, which were the ancestors of trade unions and professional associations and which had provided the only source "of mutual assistance outside the family."[438] Concomitantly, the *Loi Le Chapelier* outlawed "any voluntary association except political clubs."[439] The impetus for both of these laws was "a Rousseauian concept of the state as the achievement of the collective interest of the French people: 'No one is allowed to incite citizens to have an intermediary interest [between their own and the State's], to separate them from the Nation by a spirit of cooperation.'"[440] Beginning in 1810, however, the *Loi Le Chapelier* was somewhat relaxed. From that time through the end of the nineteenth century, only the formation of associations of more than twenty persons was

432. *Id.*
433. *Id.* at 21.
434. *Id.* at 22.
435. *Id.*
436. *Id.* at 23.
437. *Id.* at 26.
438. *Id.* at 28.
439. *Id.* Despite their initial exemption, political associations soon suffered the same fate as other voluntary associations; they became subject to the prohibition after 1795. *Id.* at 29.
440. Edith Archambault, *France*, *in* DEFINING THE NONPROFIT SECTOR, *supra* note 264, at 103, 104.

restricted.[441] Such associations could not be created without government approval, which was "sparingly granted,"[442] and leaders of unauthorized associations were subject to criminal punishment.[443] The French nonprofit sector did not begin to "shed its illegality"[444] until the late nineteenth century—when the crime of coalition was abolished in 1864, labor unions were legalized in 1884, and voluntary associations were legalized in 1901.[445]

"[W]ith the growing importance of the Red Cross and other emergency and relief organizations," World War I proved to be a turning-point for the French nonprofit sector.[446] Between the two world wars, mutual benefit societies grew along with government social welfare programs, and then adapted to fill in the gaps left by the comprehensive social security system established in France after World War II.[447] Later, during the 1960s and 1970s, voluntary associations began to grow rapidly as a result of "[n]ew concerns" (e.g., the environment, feminism, and international development and Third World countries) "a more active 'civil society,' financial public encouragement, and favorable regulations."[448] This trend continued in the 1980s with the institution of a policy of decentralization by the Socialist government of François Mitterand, "which was further developed and implemented by successive Socialist administrations."[449] Use of the nonprofit sector was strongly encouraged as a part of this policy of decentralization, and lower levels of government "delegated some economic or social local policies to associations or shared their new responsibilities with the non-profit sector."[450] Nevertheless, a vestigial mistrust of NGOs persists in France even today.[451]

441. ARCHAMBAULT, *supra* note 429, at 29.
442. *Id.* at 36.
443. *Id.* at 29.
444. Archambault, *supra* note 440, at 104.
445. *Id.* at 104-05.
446. ARCHAMBAULT, *supra* note 429, at 37-38.
447. Archambault, *supra* note 440, at 105.
448. ARCHAMBAULT, *supra* note 429, at 44-45.
449. Archambault, *supra* note 440, at 106.
450. ARCHAMBAULT, *supra* note 429, at 46.
451. Yann Kergall, *France*, *in* TAXATION OF NON-PROFIT ORGANIZATIONS, *supra* note 353, at 389, 393 ("Nevertheless, the mistrust of associations continues. Since the Law of 1901, periodic legislative intervention has evidenced the same preoccupations: assuring liberty while at the same time maintaining a measure of government control.") (translation by author).

b. NGO Tax Relief

In France, NGOs generally take one of two legal forms: the association or the foundation.[452] The number of associations in France far outstrips the number of foundations.[453] This disparity has been attributed to the existence of a hundred-year-old legal framework regulating associations and the absence of a framework regulating foundations until a little more than a decade ago.[454]

An association is broadly defined as an agreement under which two or more persons come together on a permanent basis to conduct activities for a purpose other than sharing profits.[455] Associations are either "declared" or "undeclared." Only declared associations are vested with legal personality and the ability to receive donations.[456] An association becomes declared if it makes its existence public, which is accomplished by filing a declaration with the appropriate prefecture (i.e., local representative of the central government) and then having an abstract of that declaration included in the *Journal officiel* published by the French government.[457] Once declared, an association may apply for recognition as an association of public benefit ("recognized associations"). This status is granted by decree of the Minister of the Interior after review by the Council of State, which is the highest administrative body in France.[458] Obtaining this status is advantageous because recognized associations benefit from a "greater capacity to receive gifts and inheritances."[459] A foreign NGO that operates in France and duly declares itself to the appropriate

452. Antoine Valat et al., *France*, *in* CROSS-BORDER DONATIONS, *supra* note 356, at France–1, France–1 to –2; Patrick Frotiée & René de Monseignat, *France*, *in* INTERNATIONAL CHARITABLE GIVING, *supra* note 353, at France–1, France–1 to –2; Kergall, *supra* note 451, at 389.

453. Kergall, *supra* note 451, at 391, 394 (placing the number of associations at more than 700,000 and the number of foundations at only 500).

454. *See* Law No. 87-571 of July 23, 1987, J.O., July 24, 1987, p. 8,255 (Fr.) (regulating foundations), *available at* http://www.legifrance.gouv.fr/texteconsolide/ACEDD.htm (consolidated version) [hereinafter Law No. 87-571]; Law of July 1, 1901, J.O., July 2, 1901, p. 4,025 (Fr.) (regulating associations), *available at* http://www.legifrance.gouv.fr/texteconsolide/AAEBG.htm (consolidated version) [hereinafter Law of July 1, 1901]; Decree of Aug. 16, 1901, J.O., Aug. 17, 1901, p. 5,249 (Fr.) (regulating associations), *available at* http://www.legifrance.gouv.fr/texteconsolide/AAHBN.htm (consolidated version) [hereinafter Decree of Aug. 16, 1901]; Kergall, *supra* note 451, at 394.

455. Law of July 1, 1901, *supra* note 454, art. 1.

456. *Id.* art. 2 ; Frotiée & de Monseignat, *supra* note 452, at France–5.

457. Law of July 1, 1901, *supra* note 454, art. 5; Decree of Aug. 16, 1901, *supra* note 454, art. 1.

458. Law of July 1, 1901, *supra* note 454, art. 10; Decree of Aug. 16, 1901, *supra* note 454, arts. 8 to 13-1; Frotiée & de Monseignat, *supra* note 452, at France–2 n.2.

459. Valat et al., *supra* note 452, at France–1.

governmental authorities is generally treated in the same fashion as a declared association, and it may also apply for recognition as an association of public benefit.[460]

A foundation is defined as "an irrevocable assignment of property or rights for a nonprofit purpose of public benefit."[461] There are two types of foundations: foundations of public benefit and business foundations.[462] A foundation of public benefit does not come into existence until the Minister of the Interior issues a decree recognizing its public benefit status after review by the Council of State, and that decree is published in the *Journal officiel*.[463] A foundation of public benefit has the same capacity to receive gifts and inheritances as a recognized association.[464] A business foundation may be formed by civil and commercial companies, public establishments of an industrial or commercial character, or cooperative or mutual entities.[465] A business foundation must also be formed for a nonprofit purpose of public benefit.[466] The existence of a business foundation may not be perpetual, but must be for a fixed period of not less than five years subject to renewal for a similar period.[467] A business foundation does not come into existence until the publication of an administrative decree in the *Journal officiel*.[468] The request for the administrative decree is made to the Ministry of the Interior, which is deemed to have granted the request four months after its submission if no action has been taken before that time.[469] A business foundation is prohibited from soliciting donations from the general public.[470]

As this description of associations and foundations indicates, the ability of a NGO in France to receive contributions from the public depends upon its status. Neither undeclared associations nor business foundations are permitted to solicit donations from the general public.[471] Declared associations that are *not* recognized to be of public benefit are permitted to receive *dons manuels*, which are "hand-to-hand gift[s] made without a registered deed."[472] Only movable property such as cash or bearer shares may be the subject of

---

460. *Id.* at France–9; Kergall, *supra* note 451, at 401.
461. Valat et al., *supra* note 452, at France–1; Law No. 87-571, *supra* note 454, art. 18.
462. Law No. 87-571, *supra* note 454, arts. 18, 19.
463. *Id.* art. 18; Frotiée & de Monseignat, *supra* note 452, at France–3 to –4.
464. Valat et al., *supra* note 452, at France–1.
465. Law No. 87-571, *supra* note 454, art. 19.
466. *Id.*
467. *Id.* art. 19-2.
468. *Id.* art. 19-1.
469. *Id.*; Frotiée & de Monseignat, *supra* note 452, at France–4.
470. Law No. 87-571, *supra* note 454, art. 19-8.
471. *See supra* notes 456 and 470 and accompanying text.
472. Valat et al., *supra* note 452, at France–7; Law of July 1, 1901, *supra* note 454, art. 6.

a *don manuel*.[473] Recognized associations and foundations of public benefit are eligible to receive any contribution;[474] however, if the contribution does not qualify as a *don manuel*, then the organization must request and receive approval from the appropriate governmental authorities before accepting it.[475]

The extent to which a NGO, whether domestic or foreign, is subject to income tax in France depends on whether it is engaged in profit-making or nonprofit activities.[476] Whether a NGO's activities are classed as profit-making or nonprofit depends, in turn, on the facts of the particular situation.[477] The factual nature of this inquiry has led to differing interpretations by the courts and the tax authorities, and has caused the tax treatment of NGOs to be described as "one of the most uncertain areas" of French tax law.[478] In an effort to introduce a modicum of certainty into this area, the tax authorities issued a guideline in 1998 containing a new three-step approach for determining whether the activities of a NGO are profit-making or nonprofit in nature.[479]

The first step of this approach consists of determining whether the management of the NGO is "disinterested."[480] The management of a NGO is considered disinterested if: (i) the persons who influence the direction of the organization do not, directly or indirectly, benefit financially from the NGO's operations; (ii) the NGO does not distribute its profits, directly or indirectly, in any form that is not logically related to the purposes for which it was formed; and (iii) neither the members of the NGO nor its beneficiaries have an interest in the assets of the NGO, with the exception of the right to the return of assets contributed by the members.[481] If the

---

473. Valat et al., *supra* note 452, at France–7.

474. *Id.* at France–8; Kergall, *supra* note 451, at 395.

475. CODE CIVIL [C. CIV.] art. 910 (Fr.). In the case of gifts of up to FRF 5 million, the local prefecture must approve the contribution, and in the case of gifts exceeding FRF 5 million, the Minister of the Interior must approve the contribution. Valat et al., *supra* note 452, at France–8; Frotiée & de Monseignat, *supra* note 452, at France–6.

476. Kergall, *supra* note 451, at 401; Valat et al., *supra* note 452, at France–3, France–9 to –10. Because they lack legal personality, undeclared associations cannot benefit from any relief from taxation. Frotiée & de Monseignat, *supra* note 452, at France–3.

477. Valat et al., *supra* note 452, at France–3.

478. *Id.*

479. Instruction of Sept. 15, 1998, Bull. Officiel des Impôts 4 H-5-98, Sept. 15, 1998 (Fr.), *available at* http://www.impots.gouv.fr/documentation/reglementaire/boi/instruction15_9_98.htm [hereinafter 1998 Guideline]. The 1998 Guideline was clarified in certain respects by Instruction of Feb. 16, 1999, Bull. Officiel des Impôts 4 H-1-99, Feb. 19, 1999 (Fr.), *available at* http://www.impots.gouv.fr/documentation/reglementaire/boi/ins19299.html [hereinafter 1999 Guideline].

480. 1998 Guideline, *supra* note 479, ch. 1, § 1.

481. *Id.*

management of the NGO is not disinterested, then the NGO is considered to be engaged in profit-making activities. If, however, the management is disinterested, then the analysis proceeds to the second step of the new approach.

The second step consists of determining whether the NGO is competing with profit-making enterprises.[482] To make this determination, the activities of the NGO must be examined in order to ascertain whether the NGO is offering goods and services that are similar to those offered by profit-making enterprises in the same market.[483] If members of the public can obtain the relevant goods or services equally from the NGO or a profit-making enterprise, then the NGO is considered to be competing with profit-making enterprises.[484] If the NGO is *not* found to be competing with profit-making enterprises, then the NGO is *not* considered to be engaged in profit-making activities. If, however, the NGO is found to be competing with profit-making enterprises, then the analysis proceeds to the third, and final, step of the new approach.

The third step consists of determining whether the NGO conducts its activities in a fashion similar to a profit-making enterprise.[485] This is referred to as the "rule of the four Ps" because the benchmarks for this determination are product, public, price, and publicity.[486] Each of these "four Ps" is not, however, of equal importance; instead, they have been listed—and will be discussed—in descending order of importance:[487]

Product and public. Under the rubric of the first two Ps, the social benefit of the NGO's activities must be assessed by reference to the product being furnished and the targeted sector of the public. An activity will be considered socially beneficial either if the product being furnished meets a need that is not being met by the private sector or if the activity is undertaken to meet the needs of a sector of the public that deserves special treatment because of its social or economic situation, such as the unemployed or handicapped.[488]

Price. Under the rubric of the third P, the terms on which the goods or services are provided to the public must be examined. Normally, access to goods or services provided for the public benefit is facilitated by offering those goods or services at a net price that is lower than the market price.[489] In some cases, this condition may be

---

482. *Id.* § 2(1).
483. *Id.*
484. *Id.*
485. *Id.* ch. 1, § 2(2); Valat et al., *supra* note 452, at France–5.
486. Valat et al., *supra* note 452, at France–5.
487. 1998 Guideline, *supra* note 479, ch. 1, § 2(2).
488. *Id.* § 2(2)(A)(I)-(II).
489. *Id.* § 2(2)(C); Valat et al., *supra* note 452, at France–5.

satisfied by offering the goods or services at a price that varies in accordance with the economic or social situation of the client.[490]

Publicity. Under the rubric of the final P, the methods utilized by the NGO to perform its activities must be examined to determine whether they are similar to commercial practices. Particular attention is paid to the manner in which the NGO disseminates information concerning its activities. On the one hand, the tax authorities acknowledge that it may be appropriate for a NGO to apprise the public of its activities or to make a fundraising appeal in support of those activities, but, on the other hand, they consider systematic publicity such as billboard, magazine, radio, and television advertising to be an indication that the activity is profit-oriented.[491] If, after applying the rule of the four Ps, it is determined that the NGO conducts its activities in a fashion similar to a profit-making enterprise, then the NGO is considered to be engaged in profit-making activities.

If a NGO is engaged in profit-making activities, then the NGO is subject to corporate tax with respect to all of its activities, both profit-making *and* nonprofit.[492] Corporate tax is generally imposed at a rate of thirty-three percent,[493] subject to a surcharge of six percent for accounting years ending in 2001 and three percent for accounting years ending after January 1, 2002.[494] If, however, (i) the NGO isolates its profit-making activities from its nonprofit activities, (ii) the profit-making activities are dissociable from the nonprofit activities, and (iii) the nonprofit activities predominate, then corporate tax will be imposed *only* on the income derived from the NGO's profit-making activities.[495] Furthermore, if the management of the NGO is disinterested, its nonprofit activities predominate, and the receipts from its profit-making activities do not exceed EUR 60,000, then the NGO will be exempted from corporate tax.[496]

Income of a NGO derived from nonprofit activities is exempt from corporate tax, unless it consists of rental income, agricultural income, or income from passive investments, in which case it is taxable at a reduced rate of either ten percent or twenty-four percent.[497] A NGO that is exempt from corporate tax, or that is only

490. 1998 Guideline, *supra* note 479, ch. 1, § 2(2)(C).

491. *Id.* § 2(2)(D).

492. Code Général des Impôts [C.G.I.] art. 206(1) (Fr.).

493. *Id.* art. 219(I).

494. *Id.* art. 235 ter ZA.

495. 1998 Guideline, *supra* note 479, ch. 4; 1999 Guideline, *supra* note 479, ch. 2.

496. C.G.I. art. 206 bis (1); Instruction of Oct. 30, 2000, Bull. Officiel des Impôts 4 H-3-00, Nov. 7, 2000 (Fr.), *available at* http://www.impots.gouv.fr/documentation/reglementaire/boi/4h3-00.pdf [hereinafter 2000 Guideline].

497. C.G.I. arts. 206(5), 219 bis; Valat et al., *supra* note 452, at France–6.

subject to corporate tax at reduced rates, is exempted from the corporate minimum tax, which is imposed on the basis of turnover rather than on profit.[498] If a NGO is partially subject to corporate tax, then it will likewise be partially subject to the corporate minimum tax (i.e., only with respect to its profit-making activities).[499]

An additional tax that may be of concern to NGOs in France is the inheritance and gift tax, which is imposed on the donee of the gift or bequest.[500] Inheritance and gift tax is imposed at a rate of thirty-five percent on the first FRF 150,000 of gifts or bequests, and at a rate of forty-five percent on any excess.[501] *Dons manuels* are generally exempt from inheritance and gift tax.[502] Recognized associations and foundations of public benefit, which are the only NGOs permitted to receive contributions other than *dons manuels*, are subject to inheritance and gift tax on such contributions unless their resources are exclusively earmarked for scientific, cultural, or artistic objectives of a disinterested character or for assistance, protection of the environment, or the protection of animals.[503]

Foreign NGOs do not benefit from these exemptions from inheritance and gift tax.[504] Nevertheless, through bilateral tax treaties, France has, under certain conditions, extended the benefit of these exemptions to certain NGOs that are tax residents of Austria, Bolivia, Cameroon, Finland, Germany, Israel, Italy, the Ivory Coast, Lebanon, Mexico, Senegal, Spain, Sweden, Switzerland, and the United States.[505]

---

498. C.G.I. art. 223 septies.

499. 2000 Guideline, *supra* note 496, ¶ 32.

500. Valat et al., *supra* note 452, at France–9.

501. C.G.I. art. 777, tableau III.

502. *Id.*

503. *Id.* art. 795(2°), (4°).

504. Kergall, *supra* note 451, at 407. *But cf.* Valat et al., *supra* note 452, at France–9 to –10, –17.

505. Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital, July 31, 1995, Fr.-Isr., art. 24(6)(b), 1996 J.O. 13,901 (Fr.); Convention for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital, Dec. 15, 1994, Fr.-Bol., art. 24(5)(b), 1996 J.O. 17,389 (Fr.); Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Succession and Gift Taxes, June 8, 1994, Fr.-Swed., art. 11(2), 1996 J.O. 4,090 (Fr.); Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Inheritances, Estates, and Gifts, Mar. 26, 1993, Fr.-Aus., art. 10(2), 1994 J.O. 18,053 (Fr.) (on a case-by-case basis); Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Nov. 7, 1991, Fr.-Mex., art. 22(5)(b), 1993 J.O. 3,536 (Fr.); Convention for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Inheritances, Estates, and Gifts, Dec. 20, 1990, Fr.-Italy, art. 17(2), 1995 J.O. 5,383 (Fr.); Accord Concerning the Fiscal Treatment of Gifts Made for Public Interest Purposes, Oct. 30, 1979, Fr.-Switz., 1982 J.O. 682 (Fr.); Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Estates, Inheritances, and Gifts, Nov. 24, 1978, Fr.-U.S., art. 10, 1980 J.O. 2,274 (Fr.); Fiscal Convention, Oct. 21, 1976, Fr.-

c. Donor Tax Relief

In France, until the 1980s, the tax relief afforded for contributions made to NGOs was of a symbolic nature only.[506] At present, both individuals and companies are entitled to tax relief for contributions made to NGOs, whether domestic or foreign, that take the form of recognized associations or foundations of public benefit and that are of a philanthropic, educational, scientific, social, humanitarian, sporting, familial, or cultural character or that contribute to the promotion of the artistic heritage, the protection of the environment, or the promotion of French culture, language, or scientific knowledge.[507] If approved by the Council of State, a recognized association or foundation of public benefit may serve as an intermediary for contributions made to other organizations with similar purposes.[508] For a donation to qualify for tax relief, the NGO must carry out its activities *in* France (or *from* France, in the case of humanitarian relief efforts or the promotion of French culture, language, and scientific knowledge).[509] No tax relief is afforded for contributions to organizations that do not undertake their activities in France or that undertake only limited activities in France in favor of a restricted group of persons.[510] This restriction is apparently based on the notion that the government should only forego tax revenue in the name of encouraging the activities of a NGO if those activities "'grant[ ] a benefit to the national community.'"[511]

Cameroon, Protocol, art. 20, 1997 J.O. 1,360 (Fr.); Convention, Mar. 29, 1974, Fr.-Sen., Protocol, art. 12, 1993 J.O. 3,144 (Fr.); Convention, Apr. 6, 1966, Fr.-Côte D'Ivoire, Protocol, art. 16, 1995 J.O. 7,185 (Fr.); Convention for the Avoidance of Double Taxation and for the Establishment of Rules for Reciprocal Administrative Assistance with Respect to Taxes on Income and on Successions, Jan. 8, 1963, Fr.-Spain, art. 38, 1964 J.O. 227 (Fr.); Convention for the Avoidance of Double Taxation and the Establishment of Rules for Reciprocal Administrative Assistance with Respect to Taxes on Income and on Successions, July 24, 1962, Fr.-Leb., art. 36, 1964 J.O. 251 (Fr.); Convention for the Avoidance of Double Taxation and for the Establishment of Rules for Reciprocal Juridical and Administrative Assistance with Respect to Taxes on Income and on Capital as well as with Respect to Business and Land Taxes, July 21, 1959, Fr.-F.R.G., Protocol, art. 6, 1990 J.O. 13,546 (Fr.); Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Succession Duties, Aug. 25, 1958, Fr.-Fin., art. 12, 1959 J.O. 849 (Fr.).

506. ARCHAMBAULT, *supra* note 429, at 69-70.

507. C.G.I. arts. 200(1)(a)-(b), 238 bis (1).

508. C.G.I. arts. 200(2), 238 bis (2).

509. Valat et al., *supra* note 452, at France–11; Kergall, *supra* note 451, at 410.

510. Valat et al., *supra* note 452, at France–11; Kergall, *supra* note 451, at 410.

511. Frotiée & de Monseignat, *supra* note 452, at France–9. As indicated above, activities that benefit the national community include not only activities undertaken in France, but also certain humanitarian and cultural activities undertaken abroad. *See supra* text accompanying note 509.

Individuals are entitled to a tax credit for contributions made to qualifying NGOs.[512] The amount of the tax credit is generally equal to fifty percent of the contributions made,[513] but the total credit cannot exceed ten pecent of taxable income.[514] Companies are entitled to a deduction for their contributions made to qualifying NGOs.[515] This deduction is limited to 0.325% of turnover in the case of contributions to recognized associations and foundations of public benefit and is limited to 0.225% of turnover in the case of contributions to other NGOs.[516] Any contributions in excess of this limit can be carried over to the five succeeding taxable years.[517]

5. Costa Rica

a. Development of the Nonprofit Sector

The development of the nonprofit sector in Costa Rica has generally paralleled its development in Latin America as a whole.[518] The roots of the nonprofit sector in Latin America lie in the work of the Catholic Church, which "has been a pillar of civil society in Latin America since colonial times."[519] Nevertheless, NGOs did not truly begin to take hold in Latin America until about fifty years ago.[520] Following World War II, charitable NGOs were established "to provide medicine, food, and clothes to those in need," and U.S. NGOs that had originally been established to provide war relief began working with these organizations.[521] During the post-war period, U.S. NGOs, particularly the Rockefeller and Ford Foundations, also began actively to donate to research NGOs in Latin America.[522] The Rockefeller Foundation began to fund agricultural research and training in the 1940s, and the Ford Foundation became a leading source of funds for social science research in the 1950s and 1960s.[523] The rise of repressive military regimes in the late 1960s and 1970s

---

512. C.G.I. art. 200(1).

513. In the case of contributions that benefit needy persons, the amount of the tax credit is increased to 60%. *Id.* art. 200(4). For 2001, the maximum credit for such contributions cannot exceed EUR 400. *Id.*

514. *Id.* art. 200(1).

515. *Id.* art. 238 bis.

516. *Id.* art. 238 bis (1)-(2).

517. *Id.* art. 238 bis (3).

518. *See* CARRIE A. MEYER, THE ECONOMICS AND POLITICS OF NGOS IN LATIN AMERICA 44-46 (1999).

519. *Id.* at 25.

520. *Id.* at 46.

521. *Id.* at 25.

522. *Id.* For a study of research NGOs in Latin America, see DANIEL C. LEVY, LATIN AMERICA'S PRIVATE RESEARCH CENTERS AND NONPROFIT DEVELOPMENT: BUILDING THE THIRD SECTOR (1996).

523. MEYER, *supra* note 518, at 25-26.

caused foreign NGOs to shift their resources from public institutions to NGOs, which often sheltered politicians and intellectuals who had been ousted from their positions in government or universities through political and/or economic pressure.[524]

In Latin America, the 1980s were marked by both economic and political turmoil. During this period, an economic crisis caused many Latin American countries to reduce their public sectors and to transfer the provision of some public services to NGOs.[525] In response, social funds sprung up across Latin America to provide "funding to contractors and NGOs for the construction of social infrastructure and the delivery of emergency social programs."[526] While still in the grip of this economic crisis, Central America became "infested" with civil wars in the wake of the Sandinista revolution in Nicaragua.[527] This political instability spurred the creation of politically polarized NGOs throughout Central America.[528] The growth of NGOs in Central America did not, however, slow with the advent of peace efforts; indeed, it accelerated.[529] Adding to the sense of political turmoil, the 1980s witnessed a shift in many Latin American countries from repressive military rule toward democracy.[530] During the 1990s, NGOs experienced increased participation in the policy-making processes of these fledgling Latin American democracies.[531]

b. NGO Tax Relief

In Costa Rica, NGOs take one of two legal forms: the association or the foundation.[532] An association may be created for scientific, artistic, sporting, charitable, recreational, or other legal purposes, so long as the association does not have profit-making as its sole and exclusive goal.[533] The minimum number of incorporators necessary to create an association is ten, and the incorporators must appear before a notary public to have the association's articles of

---

524. *Id.* at 32; LEVY, *supra* note 522, at 55-59.
525. MEYER, *supra* note 518, at 33; LEVY, *supra* note 522, at 59-62.
526. MEYER, *supra* note 518, at 33.
527. *Id.*; LEVY, *supra* note 522, at 63.
528. MEYER, *supra* note 518, at 33; LEVY, *supra* note 522, at 63.
529. MEYER, *supra* note 518, at 45. *See also* LEVY, *supra* note 522, at 63-64.
530. MEYER, *supra* note 518, at 20.
531. *Id.* at 35-36.
532. Carlos Manuel Valverde & Harry J. Zürcher, *Costa Rica*, *in* INTERNATIONAL CHARITABLE GIVING, *supra* note 353, at Costa Rica–1, Costa Rica–1 to –2.
533. Law on Associations, Law No. 218, Aug. 8, 1939, art. 1 (Costa Rica), *reprinted in* REPUBLICA DE COSTA RICA: LEY DE ASOCIACIONES Y LEYES CONEXAS 5 (2d ed. 1997) [hereinafter LEY DE ASOCIACIONES].

incorporation notarized.[534] Once notarized, the articles of incorporation must be submitted to the Association Registry for registration.[535] A foundation is a private legal entity of public benefit that is not established for the purpose of making a profit.[536] A foundation may be established for the purpose of achieving (or aiding in the achievement of) educational, charitable, artistic, literary, scientific, or other social welfare activities.[537] In contrast to an association, the minimum number of persons needed to create a foundation is only one.[538] A foundation may be created either by will or public deed, and the founder may either be an individual or a legal entity, whether domestic or foreign.[539] Foundations must be registered with the Person Section of the Public Registry.[540]

Only the activities of foundations and associations of public benefit are encouraged through the Costa Rican tax laws. To qualify as an association of public benefit, an association must make an application to the Ministry of Justice.[541] The application must contain "a statement of the organization's objectives; specific plans for achieving these objectives; a statement of need for the organization's activities; and the geographic scope of the organization."[542] Among the activities that are considered to be of public benefit are "cultural or educational activities; caring for the sick, elderly or indigent; [and] protection of the environment or human rights."[543] There is no geographic limitation on where these activities may be undertaken.[544] Applications for public benefit status "are strictly reviewed" by the

---

534. *Id.* art. 18 (as amended by Law No. 6020, Jan. 3, 1977), *reprinted in* LEY DE ASOCIACIONES, *supra* note 533, at 9-10; Regulations Under the Law on Associations, Decree No. 18,670-J, Nov. 28, 1988, art. 12 (Costa Rica), *reprinted in* LEY DE ASOCIACIONES, *supra* note 533, at 20; Valverde & Zürcher, *supra* note 532, at Costa Rica–1 to –2.

535. Law on Associations, Law No. 218, Aug. 8, 1939, art. 5 (as amended by Law No. 6020, Jan. 3, 1977) (Costa Rica), *reprinted in* LEY DE ASOCIACIONES, *supra* note 533, at 6; Valverde & Zürcher, *supra* note 532, at Costa Rica–2.

536. Law on Foundations, Law No. 5338, Aug. 9, 1973, art. 1 (Costa Rica), *reprinted in* LEY DE ASOCIACIONES, *supra* note 533, at 121.

537. *Id.*

538. Valverde & Zürcher, *supra* note 532, at Costa Rica–1; Law on Foundations, Law No. 5338, Aug. 9, 1973, art. 2 (Costa Rica), *reprinted in* LEY DE ASOCIACIONES, *supra* note 533, at 121.

539. Law on Foundations, Law No. 5338, Aug. 9, 1973, art. 2 (Costa Rica), *reprinted in* LEY DE ASOCIACIONES, *supra* note 533, at 121.

540. *Id.* art. 3, *reprinted in* LEY DE ASOCIACIONES, *supra* note 533, at 121; Valverde & Zürcher, *supra* note 532, at Costa Rica–2.

541. Regulations Under the Law on Associations, Decree No. 18,670-J, Nov. 28, 1988, art. 28 (Costa Rica), *reprinted in* LEY DE ASOCIACIONES, *supra* note 533, at 24; Valverde & Zürcher, *supra* note 532, at Costa Rica–2.

542. Valverde & Zürcher, *supra* note 532, at Costa Rica–2. *See also* Regulations Under the Law on Associations, Decree No. 18,670-J, Nov. 28, 1988, art. 29 (Costa Rica), *reprinted in* LEY DE ASOCIACIONES, *supra* note 533, at 25.

543. Valverde & Zürcher, *supra* note 532, at Costa Rica–3.

544. *Id.*

government, and "the number of such organizations is rather tightly controlled" because of the "fiscal advantages" accorded to them.[545]

Foundations and associations of public benefit are exempt from income tax so long as (i) their income is dedicated exclusively to one or more of the public benefit purposes described above and (ii) their income is not distributed directly or indirectly to their members.[546] To claim this tax exemption, foundations and associations of public benefit must register with the Directorate General of Taxation.[547] Registration is accomplished by presenting a certificate of good standing from the appropriate governmental agency along with a list of the NGO's members and any other documents required by the Directorate General of Taxation.[548]

c. Donor Tax Relief[549]

Costa Rica affords tax relief to donors of contributions made to qualifying foundations and associations.[550] Donors, whether individuals, corporations, trusts, or estates, are entitled to a tax deduction for contributions made to foundations and associations that are engaged in scientific, cultural, or social welfare activities and for contributions made to civil or sporting associations that have been declared to be of public benefit.[551] To be eligible to receive tax-deductible contributions, these NGOs must be registered with, and approved by, the Directorate General of Taxation.[552] The registration and approval process entails an application to the Directorate General of Taxation, which must be accompanied by conformed copies of the articles of incorporation and by-laws of the NGO, a list of

545. *Id.*

546. Income Tax Law, Law No. 7092, Apr. 21, 1988, art. 3(ch) (Costa Rica) [hereinafter Law No. 7092], *available at* http://www.hacienda.go.cr/tributacion/marco_legal.html; Alonso Arroyo, *Costa Rica*, *in* INT'L BUREAU OF FISCAL DOCUMENTATION, LATIN AMERICA TAXATION § 2.05(a) (2000); Valverde & Zürcher, *supra* note 532, at Costa Rica–4.

547. Income Tax Regulations, Decree No. 18,445-H, Sept. 9, 1988, art. 6 (Costa Rica) [hereinafter Decree No. 18445-H] *available at* http://www.hacienda.go.cr/tributacion/marco_legal.html.

548. *Id.*

549. There is no inheritance or gift tax in Costa Rica. Arroyo, *supra* note 546, § 7.07. Accordingly, the discussion in the text below is confined to the income tax relief provided to donors of contributions made to NGOs.

550. Valverde & Zürcher, *supra* note 532, at Costa Rica–4; Law No. 7092, *supra* note 546, art. 2 (listing the persons who are subject to income tax). Note that an individual's wages are subject to a final withholding tax and cannot be offset by deductions for charitable contributions. Law No. 7092, *supra* note 546, arts. 8(b) (allowing a deduction from the general income tax for wages), 32-46 (setting forth the withholding tax regime applicable to wages).

551. Law No. 7092, *supra* note 546, art. 8(q); Arroyo, *supra* note 546, § 2.09(e).

552. Decree No. 18,445-H, *supra* note 547, art. 12(*l*)(I).

members of the NGO, and any other documents required by the Directorate General of Taxation.[553] Only contributions made after the NGO has been registered with, and approved by, the Directorate General of Taxation are deductible.[554] Contributions are deductible whether they are made in the form of money or other property[555] and whether they are made to domestic or foreign NGOs, so long as the foreign NGO is registered with, and has been approved by, the Directorate General of Taxation.[556]

6. Czech Republic

a. Development of the Nonprofit Sector

The roots of the Czech nonprofit sector lie in religion. During the Middle Ages, the Catholic Church "played a dominant role . . . in creating charitable institutions."[557] Other religions, including Judaism in particular, also contributed to the development of the Czech nonprofit sector.[558] But, as urban centers began to grow, so did secular philanthropy.[559] During the late Middle Ages and the Renaissance, the role of the Church diminished and the secularization of the nonprofit sector continued.[560]

During the period of Enlightened Absolutism that occurred in the latter half of the eighteenth century under the Habsburg Empire, the state took property from the Church and transferred it to "public charities and foundations for humanitarian and social purposes, which [were] used to centralize social care and welfare."[561] The State also introduced a secular educational system that caused "the position of the Church [to] diminish[ ] in elementary, secondary, and university education."[562] Civic associations and foundations "blossomed" during the National Revival that occurred from about 1830 to the early 1850s, and "a number of patriotic societies supporting the arts and education were formed" during the ensuing neo-absolutist period.[563]

When the Czechoslovak Republic gained its independence in 1918 and democracy was introduced, "[a] new surge of societies,

---

553. *Id.* art. 12(*l*)(I)-(III).
554. *Id.* art. 12(*l*) (flush language).
555. Valverde & Zürcher, *supra* note 532, at Costa Rica–5.
556. *Id.*
557. PAVOL FRIČ ET AL., DEFINING THE NONPROFIT SECTOR: THE CZECH REPUBLIC 2 (The Johns Hopkins Comparative Nonprofit Sector Project, Working Paper, 1998).
558. *Id.*
559. *Id.*
560. *Id.*
561. *Id.*
562. *Id.*
563. *Id.* at 3.

associations and foundations" occurred.[564] These organizations "were often formed on the basis of ethnic or religious principles for cultural, educational, and charitable activities or to attack social and health problems."[565] However, this surge of civic activities came to an abrupt end with the Nazi occupation that began in 1939.[566] Many organizations became either "dysfunctional or were banned entirely."[567] After World War II, most organizations began their work anew, "but it was not long before their development was violently interrupted again by the coup of 1948."[568]

With the advent of communism, it became impossible to conduct civic activities through independent organizations.[569] The state confiscated the property of these associations and persecuted or imprisoned "a number of democratically-minded people."[570] In a "campaign against the Church" that began in 1951, all church-related charitable and diocesan associations "were systematically dissolved," and "[i]n 1960, diocesan facilities had to relinquish their remaining social care establishments and institutions to the state." [571] All social and political activities that were permitted by the state were consolidated in the National Front, which was comprised of "a variety of political organizations, trade unions, and so-called 'voluntary social organizations.'"[572] The organizations that comprised the National Front were subsidized by the state and served "as yet another instrument of state control over social and private life."[573]

For a short period during the late 1960s, interest in civic activities "reawakened" as civic appeals were launched (e.g., SOS for Children's Family Homes) and the Scouts and Sokol (a physical education association) became active again; however, the reawakening came to a close when these activities were banned after the end of the Prague Spring in 1968.[574] During the 1980s another, longer-lasting reawakening occurred as "new educational and scientific groups, societies, and self-help cooperatives appeared."[575] Gradually, "[t]he activities of officially permitted and 'tolerated' organizations . . . started to develop outside state control."[576]

564. *Id.*
565. *Id.*
566. *Id.* at 4.
567. *Id.*
568. *Id.*
569. *Id.*
570. *Id.*
571. *Id.*
572. *Id.*
573. *Id.*
574. *Id.* at 5.
575. *Id.*
576. *Id.*

Following the 1989 revolution, an act regulating the activities of associations "was passed and new organizations independent of the state developed."[577] Organizations were formed to tend to the social and health care problems of groups that had been ignored by the state under communism (e.g., gays and lesbians, AIDS victims, the mentally ill, and the homeless) as well as to address local and regional problems.[578]

At present, "the Czech nonprofit sector is still in a period of self-identification."[579] This process has been complicated by the current negative public perception of NGOs,[580] by political obstacles (i.e., the nonprofit sector "is regarded as peripheral to the overall process of economic transformation"), and by financial obstacles (i.e., the lack of independent sources of revenue).[581]

b. NGO Tax Relief

In the Czech Republic, most NGOs take the form of a civil association.[582] The permissible activities of a civil association are not affirmatively defined by law.[583] Instead, the law negatively delineates the boundaries of a civil association's permissible activities by providing that a civil association cannot have as one of its purposes "to deny or to restrict personal, political or other civil rights because of nationality, sex, race, origin, political or other opinions, religion and social status, to foster hate and intrasigency [sic] for these reasons, to assist in violence, or otherwise to commit breach of constitution and laws."[584] Furthermore, a civil association cannot be created for the primary purpose of making a profit.[585] A civil association is created by a preparatory committee, which must be comprised of no less than three persons (including corporate bodies), of whom at least one must have reached the age of eighteen.[586] A civil association does not come into existence until it has been

---

577. *Id.*

578. *Id.*

579. *Id.* at 1.

580. *Id.*; Milton Cerny, *Czech Republic, in* INTERNATIONAL CHARITABLE GIVING, *supra* note 353, at Czech Republic–1, Czech Republic–1 to –2.

581. FRIČ ET AL., *supra* note 557, at 1.

582. Law on the Association of Citizens, Act No. 83/1990, Mar. 27, 1990, § 2(1) (Czech Rep.), *translation available at* http://www.icnl.org/library/cee/laws/czeactcitizensassociations.htm [hereinafter Law on the Association of Citizens]; FRIČ ET AL., *supra* note 557, at 6. Civil associations may also be referred to as societies, unions, movements, or clubs. Law on the Association of Citizens, *supra*, § 2(1).

583. FRIČ ET AL., *supra* note 557, at 6.

584. Law on the Association of Citizens, *supra* note 582, § 4(a).

585. *Id.* § 1(3)(b); FRIČ ET AL., *supra* note 557, at 6.

586. Law on the Association of Citizens, *supra* note 582, §§ 2(2), 6(2).

registered with the Ministry of the Interior, which determines whether the requisites for incorporation have been satisfied.[587]

NGOs may also take the form of a foundation or fund. Foundations and funds are defined as a "purposeful association[ ] of assets" that is established "for the achievement of publicly beneficial goals."[588] "Publicly beneficial goals" include the "development of spiritual values; protection of human rights or other humanitarian values; protection of the environment, cultural monuments and traditions; [and] developments in science, education, physical education and sports."[589] If there is more than one founder, a foundation or fund is established by an agreement in writing among the founders.[590] Each of the founders' signatures on the agreement must be officially verified.[591] If there is only one founder, then a foundation or fund may be established either by execution of a foundation charter or a testament, both of which must take the form of a notarial deed.[592] Foundations and funds do not obtain legal personality until they are entered in the foundation register of the register court, which also maintains the register of commercial entities.[593]

The primary difference between foundations and funds is that a foundation must have an endowment. A foundation's endowment cannot be less than CZK 500,000, must consist of "either cash kept in a special bank account, real estate, or other assets that generate substantial income," and must be entered in the foundation's register.[594] A foundation's endowment cannot itself be used to achieve the purposes for which the foundation was created.[595] Only the income from the endowment and assets not included in the endowment may be used to achieve those purposes.[596] Because it does not have an endowment, a fund may use any or all of its assets to achieve the purposes for which it was created.[597]

With the exception of administrative expenses, foundations and funds must use their assets solely for the purposes for which they

---

587. *Id.* §§ 6(1), 7(1)-(3).

588. Act on Foundations and Funds, Sept. 3, 1997, § 1(1) (Czech Rep.), *translation available at* http://www.icnl.org/library/cee/laws/czeactFoundationsEndFunds.htm [hereinafter Act on Foundations and Funds].

589. *Id.* § 1(1).

590. *Id.* § 3(1).

591. *Id.*

592. *Id.*

593. *Id.* § 5(1); FRIČ ET AL., *supra* note 557, at 8.

594. Act on Foundations and Funds, *supra* note 588, §§ 2(2), 3(4)-(5); FRIČ ET AL., *supra* note 557, at 7.

595. Act on Foundations and Funds, *supra* note 588, § 2(2); FRIČ ET AL., *supra* note 557, at 7.

596. FRIČ ET AL., *supra* note 557, at 8.

597. Act on Foundations and Funds, *supra* note 588, § 2(3).

were created.[598] To curb administrative expenses, foundations and funds must adopt a limit on the amount of such expenses that may be incurred each year, "expressed as a percentage of either the total income from the registered endowment, total grant expenditures, or the overall value of assets."[599] This limitation cannot be changed for at least five years following its adoption.[600] Additionally, foundations and funds "are expressly prohibited from using their property for the benefit of employees, members of the board of directors or the supervisory committee."[601]

Foundations and funds are also prohibited from engaging in business activities either on their own or in partnership.[602] The only exception to this rule applies to foundations, which are permitted to hold interests in publicly-traded joint stock companies. A foundation may in no event, however, hold more than a twenty percent interest in any joint-stock company, and its total investments in joint-stock companies cannot exceed twenty percent of its assets, not including its endowment.[603]

The Czech Republic recently created an additional legal form for NGOs—the public benefit corporation. A public benefit corporation is defined as a legal entity that "renders generally beneficial services to the general public and to all clients under identical terms and conditions and . . . the profit of which may not be used for the benefit of its Founders, members of its bodies or employees and must serve to render the generally beneficial services for which [it] was established."[604] If there is more than one founder, a public benefit corporation is established by an agreement in writing among the founders.[605] Each of the founders' signatures on the agreement must be officially verified.[606] If there is only one founder, then a public benefit corporation is formed by a deed of establishment, which must take the form of a notarial deed.[607] The founders of a public benefit corporation may include individuals as well as legal and

598. *Id.* § 21(1)-(2); FRIČ ET AL., *supra* note 557, at 8.

599. FRIČ ET AL., *supra* note 557, at 8. *See also* Act on Foundations and Funds, *supra* note 588, § 22(1).

600. Act on Foundations and Funds, *supra* note 588, § 22(2).

601. FRIČ ET AL., *supra* note 557, at 8. *See also* Act on Foundations and Funds, *supra* note 588, §§ 21(5), 23(6).

602. Act on Foundations and Funds, *supra* note 588, § 23(1), (4)-(5); FRIČ ET AL., *supra* note 557, at 8.

603. Act on Foundations and Funds, *supra* note 588, § 23(4); FRIČ ET AL., *supra* note 557, at 8.

604. Law on Public Benefit Corporations, Act No. 248/1995, Sept. 28, 1995, art. 2(1) (Czech Rep.), *translation available at* http://www.icnl.org/library/cee/laws/czeact248.htm [hereinafter Law on Public Benefit Corporations].

605. *Id.* art. 4(1).

606. *Id.*

607. *Id.*

governmental entities.[608] The public benefit corporation obtains legal personality when it is entered in the public benefit corporations register of the register court, which, as mentioned above, also maintains the register of commercial entities and of foundations and funds.[609]

In addition to its publicly beneficial services, a public benefit corporation may engage in "complementary operations" that "improve the utilization of [its] assets without jeopardizing the quality, scope and availability of the publicly beneficial services" that it renders.[610] A public benefit corporation is not prohibited from making a profit from its activities, but those profits "must first be assigned to a reserve fund to cover any future losses and then may be used for the extension of the services for which the public benefit corporation was established."[611] A public benefit corporation may not, however, participate in the commercial activities of other persons.[612]

As this description of civil associations, foundations and funds, and public benefit corporations indicates, the ability of Czech NGOs to engage in business activities is limited. Nevertheless, to the extent that Czech NGOs do generate income, whether through permissible business activities or through activities related to their public benefit purposes, they will be subject to income tax unless the item of income generated is specifically exempted from tax.[613] Among the items of income that are exempted from tax, are: (i) subsidies and other forms of support received from the state,[614] (ii) interest on amounts held in a current account,[615] and (iii) membership fees.[616] Foundations are also generally exempted from tax on the income derived from their endowment.[617] NGOs calculate their income tax separately with respect to "each program area."[618] If a NGO has a net loss in one program area and net income in another, the NGO can claim a tax allowance equal to CZK 100,000 or thirty percent of the relevant tax base (but not in excess of CZK 3 million), whichever is greater,

608. *Id.* art. 3.
609. *Id.* art. 5(1).
610. *Id.* art. 17(1).
611. FRIČ ET AL., *supra* note 557, at 9. *See also* Law on Public Benefit Corporations, *supra* note 604, art. 17(3)-(4).
612. Law on Public Benefit Corporations, *supra* note 604, art. 17(2).
613. Income Tax Act, Act No. 586/1992, §§ 17(1), 18(1) (Czech Rep.), *translated in* CZECH TAXATION IN 2000, at 72 (2000).
614. *Id.* § 18(4)(b), *translated in* CZECH TAXATION IN 2000, *supra* note 613, at 73.
615. *Id.* § 18(4)(c), *translated in* CZECH TAXATION IN 2000, *supra* note 613, at 73.
616. *Id.* § 19(1)(a), *translated in* CZECH TAXATION IN 2000, *supra* note 613, at 75.
617. *Id.* § 19(1)(r), *translated in* CZECH TAXATION IN 2000, *supra* note 613, at 77.
618. FRIČ ET AL., *supra* note 557, at 11.

"provided the amount will be fully used to offset losses in other related programs."[619]

In the Czech Republic, the recipient of a gift, bequest, or devise is subject to gift or inheritance tax.[620] Although taxable recipients include both individuals and legal entities,[621] NGOs are exempted from gift and inheritance taxes under certain circumstances. Property received by a civil association with its seat on the territory of the Czech Republic is exempt from the gift and inheritance taxes if the property is "determined for financing facilities and humanitarian events relating to culture, schools, science and education, health care, social care, environment, physical education, sports, education and protection of children and youth, and fire protection"—provided that the civil association was itself established for performing such activities.[622] Property received by a public benefit corporation is exempt from the gift and inheritance taxes if the property is more generally "determined for [its] activities."[623] Foundations and funds benefit from the least restrictive exemption, as *any* property received by a foundation or fund is exempt from the gift and inheritance taxes.[624]

c. Donor Tax Relief

In the Czech Republic, both individuals and corporations are entitled to tax relief for contributions made for "public benefit purposes" to legal entities that have their registered office on the territory of the Czech Republic.[625] Public benefit purposes include: (i) science and education, research and development, culture, schools, the police, fire-prevention services, youth welfare, and animal protection; (ii) social, health care, environmental, or humanitarian purposes; and (iii) physical education and sports.[626] No tax relief is allowed for contributions made to a foreign NGO, and, to qualify as an eligible recipient, a domestic NGO must limit its operations to the

---

619. *Id.* at 11. *See also* Income Tax Act, Act No. 586/1992, § 20(7) (Czech Rep.), *translated in* CZECH TAXATION IN 2000, *supra* note 613, at 78-79.

620. Inheritance Tax, Gift Tax and Real Estate Transfer Tax Act, Act No. 357/1992, §§ 2, 5(1) (Czech Rep.), *translated in* CZECH TAXATION IN 2000, *supra* note 613, at 447, 449, 453.

621. *Id.* § 11, *translated in* CZECH TAXATION IN 2000, *supra* note 613, at 453.

622. *Id.* § 20(4)(a), *translated in* CZECH TAXATION IN 2000, *supra* note 613, at 460.

623. *Id.* § 20(4)(c), *translated in* CZECH TAXATION IN 2000, *supra* note 613, at 460.

624. *Id.* § 20(4)(d), *translated in* CZECH TAXATION IN 2000, *supra* note 613, at 461.

625. FRIČ ET AL., *supra* note 557, at 12.

626. Income Tax Act, Act No. 586/1992, §§ 15(8), 20(8) (Czech Rep.), *translated in* CZECH TAXATION IN 2000, *supra* note 613, at 69, 79.

Czech Republic.[627] This restrictive approach to tax relief for contributions made to foreign NGOs may reflect the fact that (i) the Czech nonprofit sector is still in its infancy; (ii) the public generally distrusts NGOs and generally "appear[s] to equate the nonprofit sector with fraudulence, waste of public resources, or inconsequential fringe groups";[628] and (iii) "low interest in providing support for the nonprofit sector and the failure to recognize its potential social and economic impact have been the main features of the relationship between the government and the nonprofit sector in the recent past."[629]

The form of the tax relief—a deduction from the tax base—is the same for all taxpayers, but the limitations on the deduction differ depending on whether the taxpayer is an individual or corporation. An individual is entitled to a deduction for her contributions only if her total contributions for the taxable period exceed either two percent of her tax base or CZK 1,000.[630] If an individual's contributions exceed this threshold, they will be deductible up to a maximum of ten percent of the individual's tax base.[631] A corporation is entitled to a deduction for its contributions only if its total contributions for the taxable period exceed CZK 2,000.[632] If the corporation's contributions exceed this threshold, they will be deductible up to a maximum of two percent of the corporation's tax base.[633]

7. The Netherlands

a. Development of the Nonprofit Sector

The roots of the Dutch nonprofit sector "can be traced to church related activities in poor relief, health care and education."[634] With the advent of Protestantism in the sixteenth century, religious diversity began to emerge in the Netherlands.[635] This diversity spurred the growth of sectarian organizations and culminated in the "pillarization" that occurred in the late nineteenth and early

---

627. Cerny, *supra* note 580, at Czech Republic–8.

628. FRIČ ET AL., *supra* note 557, at 15.

629. *Id.* at 16.

630. Income Tax Act, Act No. 586/1992, § 15(8) (Czech Rep.), *translated in* CZECH TAXATION IN 2000, *supra* note 613, at 69.

631. *Id.*

632. *Id.* § 20(8), *translated in* CZECH TAXATION IN 2000, *supra* note 613, at 79.

633. *Id.*

634. VIC VELDHEER & ARY BURGER, HISTORY OF THE NONPROFIT SECTOR IN THE NETHERLANDS 23 (The Johns Hopkins Comparative Nonprofit Sector Project, Working Paper, 1999).

635. *Id.* at 19-20, 23-24.

twentieth centuries.[636] The phenomenon of pillarization occurred at all socio-economic, political, and cultural strata of Dutch society, and resulted in "a great variety of denominational organizations such as political parties, labor unions, housing associations, newspapers, broadcasting associations, and also schools, hospitals and sport clubs."[637] Pillarization continued to be the "most dominant characteristic" of the Dutch nonprofit sector until the 1960s, when its dominance began to weaken.[638]

Despite the important influence of religion, nonreligious and nonsectarian initiatives also made significant contributions to the creation and development of the Dutch nonprofit sector.[639] The *Maatschappij tot Nut van 't Algemeen* (Society for the General Good) is an example of a nonsectarian organization that "has left its mark on the whole structure of Dutch society."[640] The Society for the General Good was founded in 1784 to educate "the ordinary people."[641] To achieve this purpose, the society "set up a national training school, published many school books, and established a book fund."[642] The society also founded elementary schools and lending libraries, and it targeted adults "by organizing evenings and lectures."[643] Over time, the Society for the General Good also "undertook efforts aimed at fighting poverty and caring for the poor," and it focused attention on pressing social issues through the publication of "thorough-going reports."[644] After World War I, the society's activities shifted somewhat from social issues to cultural activities.[645]

The government has also played a role in the development of the Dutch nonprofit sector. Municipal authorities became involved in the activities of religious and nonreligious organizations "at a very early date."[646] For some time, governmental involvement in the nonprofit sector was confined to financial support, and private organizations handled matters themselves.[647] But, as the government's financial commitment to the nonprofit sector has grown, so has its desire "to play a role in the decision-making within the sector."[648] In

---

636. *Id.* at 19, 21. "Pillarization (*Verzuiling* in Dutch) is the process by which groups of citizens organize themselves along religious and political lines." *Id.* at 21.

637. *Id.*

638. *Id.* at 20.

639. *Id.* at 24.

640. *Id.* at 8.

641. *Id.*

642. *Id.* at 9.

643. *Id.*

644. *Id.* at 9-10.

645. *Id.* at 10.

646. *Id.* at 25.

647. *Id.* at 20, 26.

648. *Id.* at 26.

particular, the influence of the central government has grown markedly since 1945, and it now extends "across virtually all areas of care and welfare."[649] Recently, however, there has been a move "towards a more hands-off approach on the part of the government."[650]

b. NGO Tax Relief

In the Netherlands, NGOs generally take the form of either a foundation or an association, with the foundation being the more common of the two forms.[651] A foundation is an entity that administers capital for a certain purpose, has no shareholders or members, and cannot make distributions to its founders or managing directors.[652] A foundation may be formed either by execution of a deed before a notary public or under a will executed before a notary public.[653] In contrast, an association has members, but it cannot have the realization of profits for distribution to those members as one of its purposes.[654] An association can be formed with or without the execution of a deed; however, an association that is formed without the execution of a deed cannot receive legacies, and its members remain personally liable for all of its debts.[655] After execution of the deed establishing the entity, the foundation or association is required to be entered in the foundations register (*Stichtingenregister*) or the associations register (*Verenigingenregister*), as appropriate, of the local Chamber of Commerce and Industry.[656]

Although there is historical evidence that foundations were intended to be used solely for charitable purposes, foundations are not required to include a charitable purpose in their charters as a

---

649. *Id.* at 21.

650. *Id.* at 25.

651. John Graham & Dries Duynstee, *The Netherlands*, *in* INTERNATIONAL CHARITABLE GIVING, *supra* note 353, at The Netherlands–1, The Netherlands–1; Ineke A. Koele & K.L. Harrie van Mens, *Netherlands*, *in* TAXATION OF NON-PROFIT ORGANIZATIONS, *supra* note 353, at 621, 622; René Offermanns & Paul J. te Boekhorst, *Netherlands*, *in* CROSS-BORDER DONATIONS, *supra* note 356, at The Netherlands–1, Netherlands–1.

652. Graham & Duynstee, *supra* note 651, at The Netherlands–1; Koele & van Mens, *supra* note 651, at 622; Offermanns & te Boekhorst, *supra* note 651, at Netherlands–1.

653. Graham & Duynstee, *supra* note 651, at The Netherlands–2.

654. *Id.* at The Netherlands–1.

655. *Id.* at The Netherlands–2; Offermanns & te Boekhorst, *supra* note 651, at Netherlands–1.

656. Graham & Duynstee, *supra* note 651, at The Netherlands–2 to –3; Offermanns & te Boekhorst, *supra* note 651, at Netherlands–1.

prerequisite to formation.[657] In fact, foundations have increasingly come to be used for commercial and private purposes in the Netherlands.[658] A charitable purpose is also not necessary for a foundation or association to qualify for preferential corporate income tax treatment.[659] Simply by reason of their form of organization, foundations and associations are subject to corporate income tax in the Netherlands only to the extent that they engage in business activities or engage in activities that compete with taxable commercial enterprises.[660] Any income of a foundation or association that is unrelated to such commercial activities, including portfolio investment income, is completely exempt from tax.[661]

A further exemption from corporate income tax is provided for entities that carry on business activities that benefit the public.[662] Among the activities that will support a tax exemption are activities that benefit the sick, elderly, and poor.[663] If, however, an entity that qualifies for this exemption earns a profit, including profits on liquidation, that profit must be used for the benefit of other exempt organizations or for the public benefit.[664]

Foreign NGOs are subject to tax in the Netherlands on a somewhat broader base than domestic NGOs.[665] Foreign NGOs are subject to tax on "any business income derived through a permanent establishment in the Netherlands and any income from Dutch real property."[666] Absent a bilateral tax treaty, the NGO will also be subject to tax on certain interest and dividends received from Dutch entities.[667]

In the Netherlands, gift and inheritance tax is imposed on the recipients of gifts, bequests, and devises.[668] NGOs benefit from a preferential gift and inheritance tax regime, but only if they are organized for religious, charitable, cultural, or scientific purposes.[669] Qualifying NGOs are exempt from tax on gifts, bequests, and devises that fall below a de minimis threshold (for 2001, NLG 8,394 for gifts

---

657. Koele & van Mens, *supra* note 651, at 622-23.

658. *Id.* at 623.

659. *Id.*; Offermanns & te Boekhorst, *supra* note 651, at Netherlands–2. *See also* NETH. MINISTRY OF FIN., TAXATION IN THE NETHERLANDS 2001 § 3.1 (2001), *available at* http://www.minfin.nl/default.asp?CMS_TCP=tcpAsset&id=A5AC250C5B6745B5B67B9434 2DDBEB21 [hereinafter NETHERLANDS 2001].

660. Koele & van Mens, *supra* note 651, at 623-24.

661. *Id.* at 623-24, 630-31.

662. Offermanns & te Boekhorst, *supra* note 651, at Netherlands–2.

663. *Id.*

664. *Id.*

665. Koele & van Mens, *supra* note 651, at 628.

666. *Id.*

667. *Id.*

668. Offermanns & te Boekhorst, *supra* note 651, at Netherlands–4; NETHERLANDS 2001, *supra* note 659, § 2.2.1, at 13.

669. Offermanns & te Boekhorst, *supra* note 651, at Netherlands–4.

and NLG 17,090 for bequests and devises).[670] If they exceed this de minimis threshold, the gifts, bequests, and devises are taxed at a reduced, flat rate—so long as they are not subject to a condition that prevents their use for the public benefit.[671] Gifts, bequests, and devises to foreign NGOs generally do not qualify for this preferential treatment.[672]

c. Donor Tax Relief

In the Netherlands, both individuals and corporations are entitled to a deduction for contributions made to qualifying NGOs. A qualifying NGO is a domestic NGO that is organized for charitable, religious, scientific, cultural, or other public benefit purposes.[673] Since 1990, a foreign NGO will be considered a qualifying NGO for this purpose if either (i) the scope of the foreign NGO's activities extends to the Netherlands or (ii) the foreign NGO's activities are of a supranational character (e.g., environmental protection).[674] There is no requirement that a NGO apply to the government for recognition or approval of its status as an entity eligible to receive deductible contributions.[675] This "rather liberal and practical approach"[676] to tax relief for contributions made to foreign NGOs is likely a product of the Netherlands' historic "orient[ation] toward foreign countries," which is reflected in its tax system in general.[677]

In the case of an individual, contributions made to qualifying NGOs are deductible to the extent that they exceed NLG 132 or one

670. *Id.*
671. *Id.*
672. *Id.* at Netherlands–8; Koele & van Mens, *supra* note 651, at 639.
673. NETHERLANDS 2001, *supra* note 659, §§ 3.2.10, 4.2.3(X); Offermanns & te Boekhorst, *supra* note 651, at Netherlands–3.
674. Ineke A. Koele, *Netherlands*, 37 EUR. TAX'N 354, 355 (1997); Koele & van Mens, *supra* note 651, at 638; Offermanns & te Boekhorst, *supra* note 651, at Netherlands–3.
675. Graham & Duynstee, *supra* note 651, at The Netherlands–4.
676. Koele, *supra* note 674, at 354.
677. Kees van Raad, *General Description: The Netherlands*, *in* AULT ET AL., *supra* note 154, at 81, 95. In support of this contention, Professor van Raad points out that the Netherlands derives "an unusually large share of its GNP from import and export activities," and that "both foreign direct investment by Netherlands companies and investment in The Netherlands by foreign companies are large . . . in comparative and in absolute terms." *Id.* *See also* Dick Hofland & Michaela Vrouwenvelder, *Netherlands Finance Minister Releases International Tax Policy Report*, WORLDWIDE TAX DAILY, Aug. 24, 1998, *available at* LEXIS 98 TNI 163-2 (1998); Michael Molenaars & Emile Bongers, *Report Recommends Changes to Netherlands' Corporate Tax Regime*, 12 J. INT'L TAX'N 58 (2001); Jeroen Pit & Klaas Verrips, *New Tax Incentives Enhance Netherlands as International Investment Location*, 6 J. INT'L TAX'N 217 (1995).

percent of taxable income, whichever is higher.[678] The deduction may not, however, exceed ten percent of the individual's taxable income.[679] Neither of these limitations applies to a contribution made by an individual to a qualifying NGO if the contribution (i) is memorialized in a notarial deed and (ii) takes the form of annual payments to be made for a minimum period of five years.[680] In the case of a corporation, contributions are deductible to the extent that they exceed NLG 500.[681] The deduction may not, however, exceed six percent of the corporation's taxable income.[682]

8. Spain[683]

a. NGO Tax Relief

In 1994, Spain enacted Law 30/1994 to overhaul its laws concerning NGOs and to clear away "the legislative brambles created by disparate and dispersed rules, the force and effect of which are more than doubtful."[684] The purpose of this overhaul was "to bring to these rules clarity and rationality and to strengthen legal certainty, while at the same time facilitating the work of those subject to the rules," namely NGOs.[685] At present, only the activities of foundations and associations that are declared to be of public benefit are encouraged through the tax provisions in Law 30/1994.

A foundation is a nonprofit organization the funds of which are permanently dedicated to the realization of goals that are of "public interest."[686] To be of public interest, a foundation's goals must relate to social assistance; civic, educational, or scientific matters; sports; health; cooperation for development; protection of the environment;

678. Kees van Raad, *Business Operations in the Netherlands*, Tax Mgmt. (BNA) No. 973-2nd, § VII (B)(2)(b)(2)(c)(v) (2002).

679. Koele & van Mens, *supra* note 651, at 637; Offermanns & te Boekhorst, *supra* note 651, at Netherlands–3.

680. Koele & van Mens, *supra* note 651, at 637; Offermanns & te Boekhorst, *supra* note 651, at Netherlands–3.

681. Offermanns & te Boekhorst, *supra* note 651, at Netherlands–3; NETHERLANDS 2001, *supra* note 659, § 3.2.10.

682. Offermanns & te Boekhorst, *supra* note 651, at Netherlands–3; NETHERLANDS 2001, *supra* note 659, § 3.2.10.

683. A description of the development of the nonprofit sector in Spain has been omitted due to a lack of sources exploring this topic. Again, this lack of source material is likely explained by the fact that study of the nonprofit sector, both here and abroad, is still in its infancy.

684. Preamble to Law 30/1994, of 24 November, Regarding Foundations and Tax Incentives to the Private Participation in Activities of Public Interest, (B.O.E., 1994, 282) (Spain) [hereinafter Law 30/1994] (translation by author), *available at* http://www.minhac.es/tributos/PDFs/Ley_30-1994.pdf.

685. *Id.*

686. Law 30/1994, *supra* note 684, art. 1(1); Alvaro de la Cueva, *Spain*, *in* CROSS-BORDER DONATIONS, *supra* note 356, at Spain–1, Spain–1.

encouragement of the economy or research; promotion of volunteer work; or other similar goals.[687] A foundation may be created by individuals or legal entities (whether public or private), and it may be created either by means of a notarial deed or by will.[688] A foundation will not, however, come into existence until it is entered in the Register of Foundations.[689]

A foundation must be governed by a board of directors whose members serve without pay, other than the reimbursement of expenses related to the performance of their duties.[690] The foundation must also use at least seventy percent of its net income in furtherance of its public interest purposes within the three-year period beginning at the time the funds are received.[691] Any remaining income, after the deduction of management expenses, must be added to the foundation's endowment.[692] A foundation is permitted to own an interest in an entity that enjoys limited liability, and it may even be a majority shareholder of such an entity, but a foundation is prohibited from owning an interest in a business enterprise with unlimited liability.[693]

Both foundations that plan to carry out their activities primarily in Spain and foundations that register in Spain but that plan to carry out their activities primarily abroad must be domiciled in Spain.[694] For this purpose, a foundation is considered to be domiciled at its seat of management.[695] Foreign foundations that plan to carry on activities in Spain must establish an office in Spain and must be entered in the Register of Foundations.[696] Entry in the Register of Foundations may be refused if the goals of the foreign foundation are not of public interest (as described above), or if the foundation was not validly created under the laws of its jurisdiction of organization.[697]

---

687. Law 30/1994, *supra* note 684, art. 2(1).
688. *Id.* arts. 6(1), 7(1)-(3); de la Cueva, *supra* note 686, at Spain–2.
689. Law 30/1994, *supra* note 684, art. 3(1); de la Cueva, *supra* note 686, at Spain–1.
690. Law 30/1994, *supra* note 684, art. 13(4), (6); de la Cueva, *supra* note 686, at Spain–2.
691. Law 30/1994, *supra* note 684, art. 25(1)-(2); de la Cueva, *supra* note 686, at Spain–2.
692. Law 30/1994, *supra* note 684, art. 25(1); de la Cueva, *supra* note 686, at Spain–2.
693. Law 30/1994, *supra* note 684, art. 22; de la Cueva, *supra* note 686, at Spain–2.
694. Law 30/1994, *supra* note 684, art. 4; de la Cueva, *supra* note 686, at Spain–2.
695. Law 30/1994, *supra* note 684, art. 4.
696. *Id.* art. 5; de la Cueva, *supra* note 686, at Spain–11.
697. Law 30/1994, *supra* note 684, art. 5; de la Cueva, *supra* note 686, at Spain–11.

There are a number of separate laws governing different types of associations; however, the basic Spanish law governing associations is Law 191/1964.[698] Law 191/1964 permits the exercise of the right of association through an act evidencing the purpose of various individuals who, having the capacity to act, have voluntarily joined together to accomplish a defined, licit purpose identified in the association's by-laws.[699] Associations are required to register with the appropriate governmental authorities, and are entered in provincial and national Registers of Associations.[700] To be declared an association of public benefit, an association must make an application to the Ministry of Justice and the Interior and meet the following requirements:

- Its goals must relate to social assistance; civic, educational, or scientific matters; sports; health; cooperation for development; protection of the environment; encouragement of the economy or research; promotion of volunteer work; or other similar goals (each, a "public interest" purpose);
- Its activities cannot be confined to the exclusive benefit of its members, but must be open to all who meet the conditions and characteristics attendant to its purposes;
- It must lack a profit-making purpose and cannot distribute to its members the earnings that it eventually obtains;
- Upon dissolution, its property must be dedicated to the realization of public interest activities subject to the foregoing requirements;
- Members of its board of directors must serve without pay, other than the reimbursement of expenses related to the performance of their duties;
- It must have adequate personnel and material resources as well as a proper organizational structure to guarantee the fulfillment of its public interest purposes; and
- It must have been in existence and carrying out its public interest purposes and satisfying all of the foregoing requirements during, at a minimum, the two-year period prior to applying for public benefit status.[701]

In addition to meeting the organizational requirements described above, a foundation or association of public benefit must separately

698. Law 191/1964, of 24 December, Regarding Associations, (B.O.E. 1964, 311) (Spain) [hereinafter Law 191/1964], *available at* http://www.mir.es/derecho/le/le191_64.htm.

699. *Id.* art. 3(1).

700. *Id.* art. 5.

701. Law 30/1994, *supra* note 684, 13th Additional Provision (modifying Article 4 of Law 191/1964). The procedures for applying for public benefit status are set forth in Articles 2 through 4 of Royal Decree 1786/1996, of 19 July, Regarding the Procedures Relating to Associations of Public Benefit, (B.O.E. 1996, 209) (Spain), *available at* http://www.mir.es/derecho/rd/rd178696.htm.

meet the following set of requirements to qualify for the tax incentives introduced by Law 30/1994:[702]

- It must pursue one or more public interest purposes;
- It must use at least seventy percent of its net income in furtherance of its public interest purposes within the three-year period beginning at the time of the receipt of the income;
- If it holds a majority interest in a business enterprise, it must inform the Ministry of Economy and the Treasury of the existence of the interest and demonstrate that ownership of the interest contributes to the accomplishment of its public interest purposes and will not jeopardize the accomplishment of those purposes;[703]
- It must render an annual accounting to the appropriate governmental authorities;
- Upon dissolution, its assets must be dedicated to public interest purposes analogous to those pursued during its existence;
- Neither its members nor its founders, nor their spouses or relatives to the fourth degree of consanguinity, can be the principal beneficiaries of its activities, nor can they benefit from its services on special terms, unless it engages in activities relating to social assistance or sports;
- Not only must the members of its board of directors serve without pay, other than the reimbursement of expenses related to the performance of their duties, but they must also lack a direct or indirect economic interest in the results of its activities; and
- It must register with the tax authorities.[704]

Qualifying foundations and associations of public benefit are exempt from corporate income tax on income derived from activities related to their public interest purposes as well as on capital gains on contributions (e.g., gifts, bequests, and devises) made to further those purposes.[705] Included among the statutorily-enumerated categories

---

702. First Final Provision ¶ 1 of Law 43/1995, of 27 December, On the Corporate Income Tax, (B.O.E. 1995, 310) (Spain) [hereinafter Law 43/1995], *available at* http://www.minhac.es/tributos/PDFs/Ley_43-1995.pdf.

703. The procedures for complying with this requirement are set forth in Article 1 of Royal Decree 765/1995, of 5 May, Regulating Certain Questions Concerning the Regime of Tax Incentives to the Private Participation in Activities of Public Interest, (B.O.E. 1995, 123) (Spain) [hereinafter Royal Decree 765/1995], *available at* http://v2.vlex.com/es/asp/norma_detalle.asp?nrm_textocompleto=RD765-1995.xml&nrm_fechapubliboe=24/05/1995&nrm_fechact=14/04/1997&TextoNorma=765/1995.

704. Law 30/1994, *supra* note 684, arts. 42, 43, 46; de la Cueva, *supra* note 686, at Spain–3 to –4. The procedures for registering with the tax authorities are set forth in Article 2 of Royal Decree 765/1995, *supra* note 703.

705. Law 30/1994, *supra* note 684, art. 48(1); de la Cueva, *supra* note 686, at Spain–4.

of income that fall within this exemption are: (i) membership fees, (ii) public grants used for public interest purposes, and (iii) income from sponsorship agreements.[706] Capital gains realized on the disposition of tangible or intangible fixed assets or of shares in an entity are also exempt from corporate income tax, but only if the proceeds are reinvested in investments related to the NGO's public interest activities.[707]

The income derived by a foundation or association of public benefit from business activities is, however, subject to corporate income tax.[708] Nevertheless, the Ministry of Economy and the Treasury may agree to extend the exemption described in the previous paragraph to cover business income.[709] The exemption may only be extended to business income if (i) the business activities are consistent with NGO's public interest purposes, (ii) granting the exemption will not give the NGO an unfair competitive advantage over for-profit business enterprises engaged in the same activity, and (iii) the business activities are directed toward the general public.[710]

The tax base of a foundation or association of public benefit includes all non-exempt income, reduced by an amount equal to thirty percent of the interest derived from loans to third parties and one hundred percent of the rents derived from immovable property that constitutes part of the NGO's endowment—but only if this income is used for public interest purposes within one year from the date of its receipt.[711] In calculating its assessable tax base, a NGO may deduct those expenditures that are normally deductible for corporate income tax purposes, but not those expenditures that are directly or indirectly related to its public interest activities.[712] Corporate income tax is imposed on the NGO's assessable tax base at a reduced rate of ten percent.[713] In calculating its tax, a NGO is entitled to any tax credits that are generally available to companies, and a NGO is

---

706. Law 30/1994, *supra* note 684, art. 49; de la Cueva, *supra* note 686, at Spain–5.

707. Law 30/1994, *supra* note 684, art. 52; de la Cueva, *supra* note 686, at Spain–5. The foundation or association of public benefit must also have held at least a 5% interest in the entity for at least one year prior to the disposition. de la Cueva, *supra* note 686, at Spain–5.

708. de la Cueva, *supra* note 686, at Spain–4.

709. Law 30/1994, *supra* note 684, art. 48(2); de la Cueva, *supra* note 686, at Spain–4.

710. Law 30/1994, *supra* note 684, art. 48(2); de la Cueva, *supra* note 686, at Spain–4. The procedure for requesting an extension of the tax exemption to business income is set forth in Article 3 of Royal Decree 765/1995, *supra* note 703.

711. Law 30/1994, *supra* note 684, art. 50(1); de la Cueva, *supra* note 686, at Spain–5.

712. Law 30/1994, *supra* note 684, art. 51; de la Cueva, *supra* note 686, at Spain–5.

713. Law 30/1994, *supra* note 684, art. 53; de la Cueva, *supra* note 686, at Spain–6.

additionally entitled to a credit of ESP 200,000 if its only activity consists of providing free services.[714]

If a foundation or association of public benefit does not qualify for the preferential tax regime established by Law 30/1994, then it will be taxed under the normal regime applicable to foundations and associations.[715] Under the normal tax regime, foundations and associations are exempt from corporate income tax only on income derived from (i) activities related to their public interest purposes, (ii) donations made to further their public interest purposes, and (iii) capital gains arising from the transfer of goods related to their public interest purposes, but only if the proceeds are reinvested in investments related to the NGO's public interest activities.[716] Under the normal tax regime, there is no possibility of obtaining an exemption for business income, of reducing the tax base by a portion of interest and rents received, or of obtaining the ESP 200,000 tax credit for NGOs that provide free services.[717] Furthermore, under the normal tax regime, the NGO will be subject to corporate income tax at the reduced rate of twenty-five percent, rather than at the ten percent rate applicable under Law 30/1994.[718]

b. Donor Tax Relief

In Spain, both individuals and corporations are afforded tax relief for contributions made to foundations and associations of public benefit. Individuals and corporations are entitled to tax relief for contributions of (i) registered cultural assets, (ii) works of art of a guaranteed quality that are given to NGOs that pursue museum-related activities and that agree to exhibit the donated artwork, (iii) goods that will contribute to the realization of the NGO's public interest purposes, and (iv) cash gifts made to further the realization of the NGO's public interest purposes.[719] To be entitled to this tax relief, the donor must obtain a certificate from the donee NGO documenting the donation.[720] The manner in which tax relief is

---

714. Law 30/1994, *supra* note 684, art. 55; de la Cueva, *supra* note 686, at Spain–6.

715. Law 43/1995, *supra* note 702, art. 133(a).

716. *Id.* art. 134(1); de la Cueva, *supra* note 686, at Spain–6.

717. de la Cueva, *supra* note 686, at Spain–6.

718. Law 43/1995, *supra* note 702, art. 26(2)(e).

719. Law 30/1994, *supra* note 684, arts. 59, 63; Art. 55(3)(a) of Law 40/1998, of 9 December, On the Personal Income Tax and Other Tax Rules, (B.O.E. 1998, 295) (Spain) [hereinafter Law 40/1998], *available at* http://www.minhac.es/tributos/PDFs/Ley_40-1998.pdf; Law 43/1995, *supra* note 702, Sole Derogating Provision ¶ 2, First Final Provision ¶ 2; de la Cueva, *supra* note 686, at Spain–8.

720. Law 30/1994, *supra* note 684, art. 66.

provided differs depending on whether the donor is an individual or a corporation.

In the case of individuals, tax relief is provided in the form of a tax credit. If the contribution is made to a foundation or association of public benefit that qualifies for the tax regime established by Law 30/1994, then the credit is equal to twenty percent of the value of the contributed property.[721] If, however, the donee is subject to the normal tax regime applicable to foundations and associations, then the credit is equal to ten percent of the value of the contributed property.[722] In the case of registered cultural assets and works of art of a guaranteed quality, the tax credit is computed by reference to the value placed on the item by the tax authorities.[723] In the case of other in-kind contributions, the tax credit is computed by reference to the acquisition value of the property or, in the case of property manufactured by the donor, the cost of production.[724] The amount of the tax credit cannot, however, exceed ten percent of the individual's assessable tax base.[725]

In the case of corporations, tax relief is provided in the form of a tax deduction. The deduction is equal to the value of the property contributed by the corporation to foundations and associations of public benefit that qualify for the tax regime established by Law 30/1994.[726] The valuation rules used in calculating this deduction are similar, but not identical, to the rules used in calculating the tax relief afforded to individuals. In the case of registered cultural assets and works of art of a guaranteed quality, the value of the property is determined by the tax authorities.[727] In the case of other in-kind contributions, the value of the property is: (i) in the case of new goods manufactured by the donor, the cost of production; (ii) in the case of new goods acquired from third parties, acquisition value, but in no event more than market value; and (iii) in the case of goods used by the donor, book value.[728] The deduction is limited to ten percent of the corporation's tax base for the year in which the contribution is

---

721. Law 30/1994, *supra* note 684, art. 59; de la Cueva, *supra* note 686, at Spain–9.

722. Law 40/1998, *supra* note 719, art. 55(3)(b); de la Cueva, *supra* note 686, at Spain–9.

723. Law 30/1994, *supra* note 684, art. 60(1).

724. *Id.* art. 60(2).

725. Law 40/1998, *supra* note 719, art. 56(1), Sole Derogating Provision ¶ 2(10) (superseding Article 61 of Law 30/1994).

726. Law 30/1994, *supra* note 684, art. 63; Law 43/1995, *supra* note 702, Sole Derogating Provision ¶ 2; de la Cueva, *supra* note 686, at Spain–9. If the donee is subject to the normal tax regime, the contribution will generally not be deductible. Law 43/1995, *supra* note 702, art. 14(1)(e), (2).

727. Law 30/1994, *supra* note 684, art. 64(1); de la Cueva, *supra* note 686, at Spain–9.

728. Law 30/1994, *supra* note 684, art. 64(2); de la Cueva, *supra* note 686, at Spain–9.

made (before taking the charitable contribution deduction into account); this limit is increased to thirty percent in the case of contributions of registered cultural assets and works of art of a guaranteed quality.[729] Alternatively, the corporation may choose to apply a limit of 0.1% of turnover in place of the 10% limit (and a limit of 0.3% of turnover in place of the 30% limit) described in the previous sentence.[730]

Tax relief is also afforded to persons engaged in business who enter into sponsorship agreements with foundations and associations of public benefit that qualify for the tax regime established by Law 30/1994. A sponsorship agreement is a written contract between a donor and a donee organization.[731] In the contract, the donor agrees to make an economic contribution that will aid in the realization of the activities undertaken by the donee in furtherance of its public interest purposes.[732] The donee, in turn, agrees to publicize the collaboration of the donor in those activities.[733] Tax relief is provided in the form of a deduction equal to the amounts paid by the donor, limited to the greater of 5% of the donor's tax base or 0.5% of the donor's turnover.[734] In the case of individual entrepreneurs or professionals, the five percent limit is applied to the portion of the tax base attributable to net business income.[735]

Neither individuals nor corporations are liable for tax on capital gains realized upon the contribution of assets in kind.[736] In addition, gifts to NGOs are exempt from inheritance and gift tax because this tax is imposed only on *individual recipients* of gifts, bequests, and devises—tax is not imposed either on donors or on donees that are legal entities.[737]

---

729. Law 30/1994, *supra* note 684, art. 63(2); de la Cueva, *supra* note 686, at Spain–9.

730. Law 30/1994, *supra* note 684, art. 63(3); de la Cueva, *supra* note 686, at Spain–9.

731. Law 30/1994, *supra* note 684, art. 68; de la Cueva, *supra* note 686, at Spain–10.

732. Law 30/1994, *supra* note 684, art. 68; de la Cueva, *supra* note 686, at Spain–10.

733. Law 30/1994, *supra* note 684, art. 68; de la Cueva, *supra* note 686, at Spain–10.

734. Law 30/1994, *supra* note 684, art. 68; de la Cueva, *supra* note 686, at Spain–10.

735. Law 30/1994, *supra* note 684, art. 68; de la Cueva, *supra* note 686, at Spain–10.

736. Law 30/1994, *supra* note 684, arts. 61, 65; de la Cueva, *supra* note 686, at Spain–9, –10.

737. Arts. 1(1), 3(2) of Law 29/1987, of 18 December, On Inheritance and Gift Tax, (B.O.E. 1987, 303) (Spain), *available at* http://www.minhac.es/tributos/PDFs/Ley_29-1987.pdf.

Foreign foundations that are registered in Spain with the Register of Foundations are entitled to the benefits of the tax regime established by Law 30/1994, but only with respect to the activities of their Spanish office.[738] As is the case with France, this restriction is apparently based on the notion that the government should only forego tax revenue in the name of encouraging the activities of a NGO if those activities directly benefit the national community.[739]

9. Japan

a. Development of the Nonprofit Sector

The Japanese nonprofit sector has its roots in the charitable activities undertaken in Buddhist temples, with the financial support of the aristocracy, during the Japanese medieval period.[740] The Buddhist temples that carried out these activities were not "independent institutions; rather they were established in the interest of either the State or powerful clans."[741] Near the end of the Japanese medieval period, charitable activities were also undertaken by Catholic missionaries who had come to Japan to proselytize.[742] During the Edo period (1603-1868), the Japanese nonprofit sector became secularized as "the charitable power of Buddhism . . . declined" and mutual aid associations and private schools were created.[743]

When the Japanese Civil Code was enacted in 1896 during the Meiji era (1868-1912), a legal basis was provided for incorporating NGOs in the form of *koeki hojin* ("public interest corporations").[744] During the Meiji era and the pre-World War II period, the nonprofit sector was active in social welfare activities, the provision of education and educational scholarships, the funding of scholarly research, and the provision of mutual aid through neighborhood associations;[745] however, few of these activities were wholly private in nature, the majority being either "government supervised or semi-

738. Law 30/1994, *supra* note 684, 16th Additional Provision. Spain has by treaty extended the benefit of any exemptions from inheritance and gift tax to NGOs that are tax residents of France. *See supra* note 505 and accompanying text.

739. Law 30/1994, *supra* note 684, Preamble, §§ VI-VII ("In this way, a substantial incentive will be created for the carrying out of public interest activities that will decisively redound to the benefit of the community.") (translation by author).

740. Takayoshi Amenomori, *Japan*, *in* DEFINING THE NONPROFIT SECTOR, *supra* note 264, at 188, 190; Yoshinori Yamaoka, *On the History of the Nonprofit Sector in Japan*, *in* THE NONPROFIT SECTOR IN JAPAN 19, 19-21 (Tadashi Yamamoto ed., Johns Hopkins Nonprofit Sector Series No. 7, 1998).

741. Amenomori, *supra* note 740, at 190.

742. *Id.* at 191; Yamaoka, *supra* note 740, at 21.

743. Yamaoka, *supra* note 740, at 21-24.

744. Amenomori, *supra* note 740, at 192; Yamaoka, *supra* note 740, at 24-25.

745. Yamaoka, *supra* note 740, at 27-36.

governmental, semi-private in nature."[746] The Meiji era and the pre-World War II period also witnessed the creation of *onshi zaidan* ("imperial endowments") outside of the *koeki hojin* system.[747] As their name indicates, the imperial endowments were created at the direction of, and with financial support from, the emperor.[748] Each of the various imperial endowments was created for a specific purpose, such as providing medical care to the poor, health and welfare support to mothers and children, or health and welfare support to soldiers' families.[749] Businesses and others were expected to make financial contributions to the imperial endowments to supplement the imperial grant.[750]

In the post-war period, "numerous private nonprofit organizations grew up around citizen and resident movements."[751] During the 1950s and 1960s, these organizations embraced the peace movement, the anti-nuclear movement, and the human rights movement.[752] Beginning in the 1970s, there was a shift away from opposition movements toward "proactive" movements such as the consumer movement and the environmental protection movement, and later toward "such areas as welfare, education, . . . health, culture, international exchange, and international cooperation."[753] At the same time, the business community began to create more conservative grant-making foundations that focused on the fields of science and technology.[754] These foundations filled the gap left by the large number of such organizations that either had been disbanded or had ceased operating following the war.[755] The post-war period also witnessed a boom in the creation of private educational institutions at the college and junior and senior high school levels.[756] In addition, although a legal framework had been established in 1922 for creating *koeki shintaks* ("charitable trusts"), the system of charitable trusts did not become active until the late 1970s.[757] Since that time there has been a dramatic increase in the creation of charitable trusts, with their assets being dedicated to such diverse purposes as providing scholarships, international cooperation, medical research, scholarly

---

746. *Id.* at 24. *See also* Amenomori, *supra* note 740, at 192.
747. Yamaoka, *supra* note 740, at 25-26.
748. *Id.* at 26.
749. *Id.*; Amenomori, *supra* note 740, at 192.
750. Yamaoka, *supra* note 740, at 26; Amenomori, *supra* note 740, at 192.
751. Yamaoka, *supra* note 740, at 47.
752. Amenomori, *supra* note 740, at 193.
753. Yamaoka, *supra* note 740, at 47.
754. *Id.* at 44-47. *See also* Amenomori, *supra* note 740, at 193.
755. Yamaoka, *supra* note 740, at 44.
756. *Id.* at 43-44.
757. *Id.* at 41, 56.

research, the advancement of social education, and the advancement of the arts and culture.[758]

b. NGO Tax Relief

In Japan, NGOs are not confined to a prescribed legal form; rather, NGOs can take the form of a corporation, an unincorporated association, or a trust.[759] Most commonly, NGOs are formed either as public interest corporations or as unincorporated associations.[760] Although unincorporated associations far outnumber public interest corporations in Japan,[761] unincorporated associations are afforded less corporate income tax relief than public interest corporations, and donors are less likely to be afforded tax relief for contributions made to unincorporated associations than they are for contributions made to public interest corporations. The importance attached to incorporation in Japan is described in the following passage:

> While the concepts of *kō* [public] and *shi* [private] are deeply rooted in Japanese culture and Confucianism, and while their connotations may have changed somewhat in recent decades, there remains nonetheless a strong tendency to regard *kō* as superior to *shi*. . . . An important consequence of the pattern is that private initiatives, whether for-profit or nonprofit, tend to seek the "official blessing" of the public sector. The most significant aspect of public approval is the status of legal personality granted by the government authorities to private organizations. Within the Japanese context, the complex and time-consuming registration process and over-sight procedures necessary do not carry negative connotations. Moreover, the close supervision of nonprofit corporations by public authorities implies considerable influence on the part of the government in nonprofit sector affairs. Depending on the actual public agency responsible for registering the different types of nonprofit organizations . . . applicants seeking incorporation are often advised to accept former bureaucrats as members of the board or senior staff. In many cases, however, the situation is anticipated by applicants, and an offer is made to invite ex-government officials to the board of the new organizations in the hope of achieving a positive impact on the public agency in general, and those in charge of the registration procedure in particular.[762]

To incorporate, a NGO must either meet the requirements for incorporation as a public interest corporation (*koeki hojin*) under Article 34 of the Japanese Civil Code or must meet the requirements of one of the laws dealing with special classes of NGOs (e.g.,

---

758. *Id.*

759. Paul Bater & Nancy J. Payne, *Japan*, *in* CROSS-BORDER DONATIONS, *supra* note 356, at Japan–1, Japan–1; Yasuyuki Kawabata, *Japan*, *in* TAXATION OF NON-PROFIT ORGANIZATIONS, *supra* note 353, at 539, 542-43.

760. Bater & Payne, *supra* note 759, at Japan–1; Toshiaki Katsushima & Keiji Kondo, *Japan*, *in* INTERNATIONAL CHARITABLE GIVING, *supra* note 353, at Japan–1, Japan–1.

761. Amenomori, *supra* note 740, at 15; Kawabata, *supra* note 759, at 539.

762. Amenomori, *supra* note 740, at 207-08.

educational, religious, social welfare, or medical organizations).[763] There are two types of public interest corporations in Japan: incorporated associations ("*shadan hojin*") and incorporated foundations ("*zaidan hojin*.")[764] The difference between these two types of public interest corporations lies in the subject of the incorporation. In the case of an incorporated association, what is being incorporated is a "group of people associated for a public-interest purpose."[765] The association acts as a single entity, is governed by the general assembly of its members by majority vote, and its existence is unaffected by changes in the size of its membership.[766] In the case of an incorporated foundation, what is being incorporated is "an endowed fund so that the endowment donated for a public-benefit purpose will be maintained and managed in order to serve the purpose stipulated by the donor."[767] Unlike an association, a foundation has no members and is not governed by a general assembly; rather, it is governed by its directors, operating in accordance with the foundation's charter.[768]

To be incorporated as a public interest corporation, an association or foundation must promote the public interest and cannot be organized for the purpose of making a profit.[769] Among the examples of public interest activities listed in Article 34 of the Japanese Civil Code are worship, religion, charity, science, and art.[770] To be considered of public interest, these activities must benefit "society in general or many and unspecified persons."[771] The requirement that the association or foundation not be organized for the purpose of making a profit does not prevent a NGO from engaging in commercial activities, it only prevents the NGO from seeking a profit and distributing that profit among its members.[772] Furthermore, a NGO that engages in commercial activities that are unrelated to its public interest purposes must do so within the following limits: (i) the commercial activities must be undertaken "on a modest scale," meaning that they can produce no more than one-half of total revenue; (ii) the commercial activities must not be of a type that breaches the "social trust" vested in a public interest

---

763. Bater & Payne, *supra* note 759, at Japan–1; Kawabata, *supra* note 759, at 542.

764. Takako Amemiya, *The Nonprofit Sector: Legal Background*, *in* THE NONPROFIT SECTOR IN JAPAN, *supra* note 740, at 59, 60.

765. *Id.* at 65-66.

766. *Id.* at 66.

767. *Id.*

768. *Id.*

769. *Id.* at 63-64; Katsushima & Kondo, *supra* note 760, at Japan–2.

770. Amemiya, *supra* note 764, at 63.

771. *Id.* at 64.

772. *Id.* at 64-65.

corporation; (iii) the commercial activities must not impede the NGO's public interest activities; and (iv) the income from the commercial activities in excess of the amount necessary for the healthy management of the NGO must be used for public interest activities.[773]

A NGO that meets the foregoing requirements must apply to the "competent authorities" for permission to incorporate.[774] The identity of the competent authorities depends on the public interest purpose(s) that the NGO intends to undertake.[775] Thus, for example, a NGO that intends to undertake activities relating to international exchange would apply to the Ministry of Foreign Affairs for permission to incorporate, while a NGO that intends to undertake cultural, artistic, or scientific activities would apply to the Ministry of Education.[776] If the intended activities of a NGO come under the jurisdiction of more than one ministry, the permission of each affected ministry must be obtained.[777]

In 1998, a new form of incorporated NGO was introduced in Japan—the "specified nonprofit corporation."[778] The impetus for creating this new form of incorporated NGO arose out of legal difficulties that were encountered by unincorporated NGOs in carrying out relief efforts after the 1995 Hanshin-Awaji earthquake.[779] Because of their lack of legal personality, these unincorporated NGOs encountered "some difficulties such as hiring offices, receiving subsidies from public organizations/governments, auditing of their accounts, tax treatment of their activities, and so on."[780]

To be incorporated as a specified nonprofit corporation, a NGO must have as its main purpose the accomplishment of one or more "specified" nonprofit activities, and the NGO must not be organized for the purpose of making a profit.[781] Included in the list of "specified" nonprofit activities are: (i) promotion of health, medical treatment, or welfare; (ii) promotion of social education; (iii) promotion of community development; (iv) promotion of culture, the arts, or sports; (v) conservation of the environment; (vi) disaster relief; (vii) promotion of community safety; (viii) protection of human

---

773. *Id.* at 65.
774. *Id.* at 66.
775. *Id.*
776. *Id.* at 67.
777. *Id.*
778. Bater & Payne, *supra* note 759, at Japan–4; Kawabata, *supra* note 759, at 548-49. A translation of the Law to Promote Specified Nonprofit Activities is available from the Japan Center for International Exchange at http://www.jcie.or.jp/civilnet/civil_soc_monitor/npo_law.html.
779. Kawabata, *supra* note 759, at 539.
780. *Id.*
781. *Id.* at 549.

rights or promotion of peace; (ix) international cooperation; (x) promotion of a society with equal gender participation; and (xi) sound nurturing of youth.[782] To qualify as a specified nonprofit corporation, a NGO must also meet the following requirements:

- It cannot unreasonably condition the acquisition or loss of membership;
- No more than one-third of its officers may receive remuneration;
- Its activities cannot be for the purpose of spreading religious teachings, performing religious ceremonies, or proselytizing;
- Its activities cannot be for the purpose of promoting, supporting, or opposing a political principle; and
- Its activities cannot be for the purpose of recommending, supporting, or opposing a candidate for public office, a person holding a public office, or a political party.[783]

Applications to create specified nonprofit corporations must be made to the governor of the prefecture in which the main office of the NGO is to be located.[784]

The income that a Japanese NGO derives from public interest activities is exempt from corporate income tax, whether the NGO takes the form of a public interest corporation, a specified nonprofit corporation, or an unincorporated association.[785] The corporate income tax rate applicable to income derived from profit-making activities (without regard to the relation of those activities to the public interest purposes of the NGO) does, however, depend on the legal form that the NGO takes.[786] Public interest corporations are subject to corporate income tax on their income from profit-making activities at a reduced rate of twenty-two percent,[787] while specified nonprofit corporations and unincorporated associations are subject to tax on such income at the normal rates of up to thirty percent.[788] A

---

782. Bater & Payne, *supra* note 759, at Japan–4 to –5; Kawabata, *supra* note 759, at 549.

783. Kawabata, *supra* note 759, at 549.

784. Bater & Payne, *supra* note 759, at Japan–5.

785. *Id.* at Japan–3, –4; Kawabata, *supra* note 759, at 550-51.

786. Bater & Payne, *supra* note 759, at Japan–3 to –4.

787. Japanese government sources have recently indicated that "[t]he government and ruling parties will drastically review the preferential tax system for nonprofit corporations, with an eye to revising the system in fiscal 2003." *Government Eyeing Tax Changes for Nonprofit Firms*, DAILY YOMIURI (Tokyo), Jan. 12, 2002, *available at* LEXIS, News Library, The Daily Yomiuri (Tokyo) File. The catalyst for this review appears to be the widespread perception that "some nonprofit corporations, which are entrusted to provide services for or undertake business on behalf of the government, are making a large amount of profit and pressuring private firms that are engaged in similar businesses." *Id.*

788. Bater & Payne, *supra* note 759, at Japan–4. A public interest corporation that is engaged in profit-making activity may deduct contributions of income derived

foreign NGO may benefit from this partial exemption from tax and from the reduced rate of tax on income derived from profit-making activities if (i) it is designated a foreign public interest corporation by the Ministry of Finance and (ii) its main office is located in a country that extends similar treatment to Japanese NGOs.[789]

c. Donor Tax Relief

In Japan, individuals and corporations are afforded tax relief for contributions made to certain NGOs. An individual may only deduct contributions of cash made to (i) public interest corporations designated by the Ministry of Finance to be of extreme national importance, provided further that the contribution is made in the course of a public fundraising campaign; (ii) specially-designated corporations that promote the public interest; and (iii) approved specified nonprofit corporations.[790] Such contributions are deductible to the extent that they exceed JPY 10,000, up to a maximum of twenty-five percent of the donor's annual taxable income.[791] In-kind contributions made by individuals are not deductible, and any gain realized on making such a contribution is subject to income tax.[792]

A corporation may fully deduct contributions made to NGOs described in the previous paragraph.[793] Contributions made to other NGOs are also deductible, but subject to a maximum limit equal to 50% of the sum of 2.5% of profit plus 0.25% of paid-in capital.[794] If the donee NGO is a public interest corporation or is organized under a special law for the promotion of cultural, social welfare, or other designated purposes, then the corporate donor is entitled to an additional deduction of up to 50% of the sum of 2.5% of profit plus 0.25% of paid-in capital.[795] Unlike individuals, corporations may deduct contributions whether made in cash or in-kind, but any gain realized on the making of an in-kind contribution will be subject to income tax.[796]

---

from its profit-making activity that it makes to its public interest activity, up to 20% of the income derived from the profit-making activity (50% in the case of certain educational and social welfare corporations—but not in excess of JPY 2 million). *Id.* at Japan–2 to –3.

789. *Id.* at Japan–4; Kawabata, *supra* note 759, at 558-59.

790. Amemiya, *supra* note 764, at 83; Bater & Payne, *supra* note 759, at Japan–2, –7; Griffith Way et al., *Business Operations in Japan*, Tax Mgmt. (BNA) No. 969, § V(C)(9), at A-149 (2001).

791. Amemiya, *supra* note 764, at 83; Bater & Payne, *supra* note 759, at Japan–7; Way et al., *supra* note 790, § V(C)(9), at A-149.

792. Bater & Payne, *supra* note 759, at Japan–7.

793. *Id.* at Japan–2, –7.

794. *Id.* at Japan–7.

795. *Id.* at Japan –7 to –8.

796. *Id.* at Japan–7.

Neither an individual nor a corporation is, however, subject to income tax on the gain realized on making an in-kind contribution to a public interest corporation if "the contribution is recognized by the tax authorities as promoting education or science, improving culture or social welfare or otherwise contributing to the advancement of the public interest."[797] Gifts to NGOs are also exempt from inheritance and gift tax because this tax is imposed only on *individual recipients* of gifts, bequests, and devises—tax is not imposed either on donors or on donees that are legal entities.[798] Additionally, an individual recipient of a bequest or devise is exempted from inheritance tax with respect to property that he or she contributes to a specially designated corporation promoting the public interest, or to an approved specified nonprofit corporation, so long as the contribution is made within ten months of the decedent's death.[799]

A contribution made to a foreign NGO is deductible only if the foreign NGO has been designated by the Ministry of Finance as an organization to which deductible contributions may be made.[800] In practice, only a few foreign NGOs have been so designated.[801] Because of the lack of geographical limitations on the activities of Japanese NGOs, it is also possible to make deductible contributions to foreign NGOs through certain domestic intermediary NGOs, such as the Japan Foundation and the Council for Better Corporate Citizenship.[802]

B. *Identification Phase*

Once the descriptions have been completed, the next step in the comparative analysis is to compare and contrast the rules of the chosen legal systems in an effort to identify any similarities among them and differences between them. As summarized below, the instant study has revealed that, with regard to the tax treatment of contributions made by domestic taxpayers to foreign NGOs, the differences between legal systems predominate over the similarities. Rather than following a "clear or well-established trend," the countries chosen for study have adopted an entire spectrum of

797. *Id.* at Japan–8.
798. *Id.* at Japan–6.
799. *Id.* at Japan–8.
800. Kawabata, *supra* note 759, at 565; Way et al., *supra* note 790, § V(C)(9), at A-149.
801. Kawabata, *supra* note 759, at 565; Way et al., *supra* note 790, § V(C)(9), at A-149.
802. Bater & Payne, *supra* note 759, at Japan–8 to –9, –11.

approaches to the encouragement, or, in some cases, active discouragement, of contributions to foreign NGOs.[803]

The Czech Republic lies on the most restrictive end of this spectrum, because it affords no tax relief for contributions made directly to foreign NGOs and it effectively prohibits indirect contributions by limiting the operations of domestic NGOs to the domestic arena. The Czech Republic's severely restrictive approach may reflect the fact that (i) its nonprofit sector is still in its infancy, (ii) the Czech public generally distrusts and has a negative perception of NGOs, and (iii) the government has generally had little interest in supporting the nonprofit sector.[804]

Lying near the Czech Republic on the restrictive end of the spectrum are Spain and France. At first blush, Spain and France seem to have adopted rather permissive rules regarding the availability of tax relief for contributions made to foreign NGOs. Indeed, neither of these countries imposes a place-of-organization limitation on the tax relief afforded for contributions made to NGOs. Upon further inspection, however, one discovers that the availability of tax relief for contributions made to foreign NGOs is severely constrained by a place-of-use limitation. Accordingly, even though both Spain and France afford tax relief for contributions made to foreign NGOs, they limit that tax relief to contributions that support activities undertaken in Spain and France, respectively. This restriction is apparently intended to ensure that tax revenue is foregone only in exchange for a direct benefit to the "national community."[805]

Lying near the center of the spectrum are England and Wales, the United States (with regard to income tax relief for individuals and corporations), and Japan. Although England and Wales afford no tax relief for contributions made directly to foreign NGOs, the stringency of their rules is ameliorated by the fact that tax relief can be obtained by passing contributions through a domestic intermediary NGO, because domestic NGOs in England and Wales are permitted to undertake activities abroad. In the case of income tax relief for individuals and corporations, the U.S. rules are the same as those of England and Wales: tax relief is nominally denied for contributions made to foreign NGOs (unless a tax treaty provides otherwise), but tax relief can be obtained if the contribution is passed through a domestic intermediary NGO in an appropriate manner. Despite nominally affording tax relief for contributions made directly to designated foreign NGOs, the Japanese rules are also similar to

---

803. *See* David Gliksberg, *General Report*, *in* TAXATION OF NON-PROFIT ORGANIZATIONS, *supra* note 353, at 58.

804. *See supra* notes 628 and 629 and accompanying text.

805. *See supra* notes 511 and 739 and accompanying text.

those of England and Wales. Japanese taxpayers who wish to obtain tax relief for contributions made to foreign NGOs must normally pass their contributions through a limited number of domestic intermediary NGOs because the tax authorities have, in practice, only rarely designated a foreign NGO as an eligible recipient of tax-deductible contributions. In the case of both England and Wales and the United States, this moderately restrictive approach appears to be a vestige of more insular or isolationist periods in their history.[806] In the case of Japan, this approach may simply be a by-product of the fact that tax relief is generally provided to only a limited number of NGOs—either directly or indirectly through tax relief for contributions made to such NGOs.[807]

Lying near the more permissive end of the spectrum are New Zealand, Costa Rica, and the United States (with regard to estate and gift tax relief and income tax relief for trusts and estates). New Zealand affords tax relief for contributions made directly to foreign NGOs that apply for specific legislative approval, and such approval has in fact been granted to a number of foreign NGOs. New Zealand requires advance legislative approval because it views this tax relief as a form of governmental expenditure. By requiring legislative approval, New Zealand seeks to ensure that its expenditures on tax relief in support of the foreign activities of NGOs will be consistent with its foreign aid program.[808] Similarly, Costa Rica affords tax relief for contributions made to foreign NGOs that register with, and are approved by, its tax authorities. Costa Rica generally exercises tight control over grants of public benefit status, because public benefit status is accompanied by an exemption from income tax and the ability to receive tax-deductible contributions.[809] In the case of estate and gift tax relief and income tax relief for trusts and estates, the United States also falls at the more permissive end of the spectrum, because it affords tax relief for contributions made directly to foreign NGOs.

The Netherlands lies at the most permissive end of the spectrum. The Netherlands affords tax relief for contributions made directly to foreign NGOs so long as the scope of their activities either (i) extends to the Netherlands or (ii) is of a supranational character. Unlike New

---

806. *See supra* note 368 and accompanying text for a discussion of the historical context of the English and Welsh place-of-organization limitation. See TOWNSEND HOOPES & DOUGLAS BRINKLEY, FDR AND THE CREATION OF THE U.N. 8-9, 17-21 (1997), and ARTHUR M. SCHLESINGER, JR., THE IMPERIAL PRESIDENCY 95-99 (1973) for a discussion of the isolationism that dominated the national mood in the United States during the 1930s.

807. *See supra* Part V.A.9.b-c.

808. *See supra* note 418 and accompanying text.

809. *See supra* note 545 and accompanying text.

Zealand, Costa Rica, and the United States, however, the Netherlands does not require foreign NGOs to obtain governmental recognition of their eligibility to receive contributions that give rise to tax relief. This internationalist approach to tax relief for contributions made directly to foreign NGOs may be a product of the Netherlands' historic orientation toward foreign countries, which is reflected in its tax system in general.[810]

C. *Explanatory Phase*

The final step in the comparative analysis consists of a critical evaluation of what was discovered in the course of the comparison—with an eye toward developing a viable reform proposal. Both for the sake of completeness and to obtain a more global perspective, at least one representative of each of the eight "families" of income tax laws was included in this study. As described in the previous subpart, these countries have adopted widely divergent approaches to the tax treatment of contributions made by domestic taxpayers to foreign NGOs. Their approaches range from the purely nationalistic approach of the Czech Republic, which does not afford tax relief for any contribution to a foreign NGO—whether made directly or indirectly, to the internationalist approach of the Netherlands, which affords tax relief for contributions made to any foreign NGO the activities of which either extend to the Netherlands or are of a supranational character—without even requiring the NGO to register in advance with governmental authorities. Of the available choices in this spectrum of possible approaches, the internationalist approach of the Netherlands would seem to be the most in keeping with the trend toward increasing globalization and the growing recognition of the need for coordinated, multilateral solutions to emerging international tax problems.

Nonetheless, the purpose of adopting STC/Comparative Law as a framework for reform is not simply to implement the rule that is, in the abstract, "superior" to the others, but rather to determine the most "appropriate" rule by balancing the benefits of the superior rule against all of the relevant theoretical and practical considerations that normally inform U.S. international tax policy-making. In the instant situation, the relevant domestic tax policy considerations include efficiency, fairness, the competitiveness of U.S. multinationals, the impact on political relations with foreign countries, the need to raise revenue, and the prevention of tax avoidance and evasion. When these considerations are taken into account, it becomes apparent that the most "appropriate" rule for

810. *See supra* note 677 and accompanying text.

enactment by the United States is similar to, but more modest than, the "superior" rule adopted by the Netherlands.

1. Efficiency

If the United States were to emulate the Netherlands' internationalist approach, it could greatly improve the efficiency of its rules governing the tax relief afforded for contributions made to foreign NGOs. The Netherlands has generally refrained from imposing geographic limitations on the tax relief that it affords for contributions made to foreign NGOs. The United States, on the other hand, imposes a place-of-organization and a place-of-use limitation on the tax relief that it affords to individuals and corporations that make contributions to foreign NGOs. The place-of-organization limitation, which applies to both U.S. individuals and corporations, restricts income tax relief to contributions made to domestic NGOs. As a practical matter, however, this limitation has proved easy to circumvent—all that is required is for a contribution to a foreign NGO to be routed through a domestic NGO. Due to the indirect availability of tax relief, a foreign NGO that wishes actively to solicit contributions from the United States is essentially required to create a domestic NGO to serve as a conduit for those contributions. The creation and maintenance of a domestic intermediary NGO naturally entail significant administrative costs, such as filing fees, reporting requirements, and bank charges, that diminish the portion of the foreign NGO's endowment that is ultimately dedicated to purposes that benefit the public. The place-of-organization limitation therefore reduces efficiency by causing a foreign NGO to incur costs that it may not have chosen to incur absent the existence of this tax limitation.

Compounding this inefficiency is the place-of-use limitation that is imposed on contributions made by U.S. corporations. Under this limitation, a U.S. corporation that makes contributions to a domestic NGO that takes the form of a trust, chest, fund, or foundation will be afforded tax relief only if the contributed funds are to be used within the United States. Contributions made to incorporated domestic NGOs are not subject to this limitation and, as a result, give rise to tax relief whether the contributed funds are to be used within or without the United States. When this place-of-use limitation is considered in combination with the place-of-organization limitation, it becomes clear that the U.S. tax rules have created a bias in favor of using incorporated NGOs as domestic intermediaries, because only incorporated NGOs may be used as intermediaries by both U.S. individuals and corporations. The place-of-use limitation therefore further reduces efficiency by causing the choice of intermediary entity to be determined solely by reference to tax concerns. Accordingly, abolition of the place-of-organization and place-of-use limitations should produce efficiency gains.

2. Fairness

Eliminating these geographic limitations would also equalize the treatment of different categories of U.S. domestic taxpayers. At present, no geographic limitations are imposed on the income tax relief afforded for contributions made by complex trusts and estates, a place-of-organization limitation is imposed on the income tax relief afforded for contributions made by individuals—but no geographic limitations are imposed on the estate and gift tax relief afforded for these same contributions, and both a place-of-organization and a place-of-use limitation are imposed on the income tax relief afforded for contributions made by corporations. By eliminating geographic limitations with respect to all taxpayers, no category of taxpayers would be favored over any other when it comes to affording tax relief for contributions made to foreign NGOs.

3. Competitiveness

Affording tax relief for contributions made directly to foreign NGOs could enhance the competitiveness of U.S. multinational corporations. These companies have come under growing pressure to contribute to the communities in foreign countries where they have operations or employees.[811] Abolishing the geographic limitations would make it much easier for such corporate giving to occur.

4. Political Relations

Abolishing the geographic limitations could serve to improve our political relations with other countries. As discussed above, the geographic limitations have already been relaxed by treaty in the case of contributions made to Canadian, Mexican, and Israeli NGOs. While only three countries have successfully obtained a relaxation of the geographic limitations, they are clearly not the only ones interested in seeing the geographic limitations relaxed or abolished. At least two other countries—Brazil and Barbados—have expressed an interest during income tax treaty negotiations in having these limitations relaxed.

---

811. LINDA B. GORNITSKY, BENCHMARKING CORPORATE INTERNATIONAL CONTRIBUTIONS 5-6, 9 (The Conference Bd., Research Report No. 1163-96-RR, 1996).

5. Revenue

Abolishing the geographic limitations should not have a significant impact on revenue. Individuals and corporations can already obtain income tax relief for contributions made to foreign NGOs so long as they are appropriately funneled through domestic intermediaries. Moreover, for estate and gift tax purposes, individuals are currently afforded tax relief for contributions made directly to foreign NGOs.

6. Tax Avoidance and Evasion

The Netherlands has not only refrained from imposing geographic limitations on the tax relief that it affords for contributions made to foreign NGOs, but it has also refrained from requiring foreign NGOs to obtain government approval of their eligibility to receive contributions that give rise to tax relief. Although a requirement of advance government approval might, to some extent, inhibit the flow of cross-border contributions, the United States might not wish to emulate this aspect of the Netherlands' approach because it would entail too great a risk of tax avoidance and evasion. Absent a requirement of advance government approval, taxpayers could claim a deduction for contributions made to foreign NGOs in the hope that the Internal Revenue Service either (i) would not investigate the propriety of the claimed deductions or (ii) if it did investigate, would settle the matter because of the burdens of collecting the relevant information, the hazards of litigation, or other reasons.

The opportunity for tax avoidance and evasion could, however, be curtailed by limiting tax relief to contributions made to foreign NGOs that appear on a published list of organizations that have been approved by the Internal Revenue Service as eligible to receive tax-deductible contributions. In that case, an Internal Revenue Service agent would be able quickly and easily to determine whether a taxpayer was entitled to the claimed tax relief. In its Publication No. 78, the Internal Revenue Service already maintains a list of domestic NGOs that are exempt from income tax and eligible to receive tax-deductible contributions. Moreover, foreign NGOs that receive fifteen percent or more of their support from U.S. sources are currently required to apply to the Internal Revenue Service for recognition of their tax-exempt status.[812] Implementing the requirement of advance government approval would, therefore, require no more than

812. *See supra* note 295 and accompanying text.

(i) an extension of the current registration requirement to all foreign NGOs that wish to solicit contributions from U.S. donors and (ii) the publication of the names of approved organizations in Publication No. 78. It is worth noting that two of the countries included in this study—New Zealand and Costa Rica—have adopted this approach; they each limit tax relief to contributions made to foreign NGOs that have obtained advance approval from the government. In the case of New Zealand, the Parliament must provide the approval, and in Costa Rica, it is the tax authorities that must provide the approval.

Requiring advance government approval may also confer another benefit. If one takes the view that the deduction for charitable contributions is a form of governmental expenditure,[813] then, by requiring foreign NGOs to obtain government approval before such expenditures are made, the government would be able to retain tighter control over the types of activities to which the government contributes. This view has been adopted by New Zealand, which limits approval to foreign NGOs engaged in activities that are consistent with its foreign aid program.

Thus, after balancing the "superior" Netherlands approach against the relevant domestic policy considerations, it appears that the most fruitful path to reform would be to abolish the existing geographic limitations and to afford tax relief for contributions made directly to foreign NGOs, but to restrict that relief to foreign NGOs that have obtained advance approval from the Internal Revenue Service of their eligibility to receive tax-deductible contributions. Having ascertained the most appropriate rule for adoption by the United States, it is now necessary to return to the underlying purpose of adopting the proposed framework and to determine whether the adoption of this rule will reduce the existing complexity of the U.S. international tax regime.

The adoption of this rule should, in fact, result in a significant reduction of both external and internal complexity. External complexity would be reduced by bringing the U.S. rules closer in line with those of the Netherlands, New Zealand, Costa Rica, and other countries that have adopted a similar approach to the tax treatment of cross-border charitable contributions. The similarity in these rules would facilitate the cross-border activities of NGOs that are indigenous to this group of countries by reducing transaction costs and delays and by enabling such activities to be conducted in the framework of familiar laws. Even though no well-established trend

---

813. Recognizing, of course, that there is some controversy concerning the tax expenditure concept and its appropriate boundaries. *See, e.g.*, Thomas D. Griffith, *Theories of Personal Deductions in the Income Tax*, 40 HASTINGS L.J. 343, 345-66 (1989); Douglas A. Kahn & Jeffrey S. Lehman, *Tax Expenditure Budgets: A Critical View*, 54 TAX NOTES 1661 (1992); Victor Thuronyi, *Tax Expenditures: A Reassessment*, 1988 DUKE L.J. 1155, 1163-70 (1988).

exists in this area, one can only expect that, as the nonprofit sectors of other countries continue to evolve and mature and as the trend toward globalization continues, other countries will subscribe to the progressive, internationalist approach of the Netherlands, New Zealand, and Costa Rica. As additional countries adopt this approach, external complexity will be further reduced.

By focusing attention on the results of the comparative analysis, the proposed framework effectively constrains the tendency of the conflicting policy considerations that normally inform U.S. international tax policy-making to produce internal complexity. In the case of the instant reform proposal, the proposed framework would not only prevent the current level of internal complexity from increasing, but would actually reduce it. First, by adopting the same rule for income and estate and gift tax purposes, the possibility that a contribution made by an individual may be deductible for estate or gift tax purposes but not for income tax purposes would be eliminated. Second, by adopting the same rule for all persons subject to the income tax, the current complexity created by imposing different requirements on contributions made by individuals, corporations, and estates and complex trusts would be eliminated. Moreover, as described above, adopting the same rule for all taxpayers would level the playing field by ensuring that one group of taxpayers is not favored over the others. Third, by limiting tax relief to contributions made to foreign NGOs that have obtained advance government approval, all that a taxpayer (whether an individual, a corporation, an estate or a trust) would need to do to ensure its ability to claim a tax deduction would be to find the name of the foreign NGO in Internal Revenue Service Publication No. 78, which currently lists the domestic NGOs that are eligible to receive tax-deductible contributions.[814] Individuals and corporations would no longer need to ensure that a domestic intermediary NGO has adopted an appropriate procedure for passing contributions along to foreign NGOs, and corporations would no longer need to take the further step of determining whether the domestic intermediary NGO is incorporated.

VI. CONCLUSION

The U.S. international tax regime has reached the point where it is in danger of collapsing under the weight of its own complexity.

---

814. It is worth noting that a searchable version of Publication No. 78 is available to taxpayers on the Internal Revenue Service's web site at http://apps.irs.gov/search/eosearch.html.

Nevertheless, commentators engaged in the ongoing debate over how to reform this regime have paid little attention to the mundane need for simplification, instead focusing their energy on abstract efficiency and fairness concerns. When they have seriously considered the need for simplification, these commentators have taken a parochial view of the problem. The purpose of this Article has been to underscore the need for simplification while bringing a more practical dimension to the reform debate by broadening the perspective from which the U.S. international tax regime and, in turn, the problem of complexity, is viewed.

When the problem is viewed solely from a national perspective, it appears that only the internal complexity of the U.S. international tax regime needs to be addressed in order to achieve simplification. While a certain measure of internal complexity inheres in any mature system of legal rules, the current level of internal complexity in the U.S. international tax regime exceeds that which can be attributed to the maturation process alone. The excess complexity has been attributed, in part, to the failure of Congress to take an integrated approach to the formulation of U.S. international tax policy. But, given the multitude of conflicting theoretical and practical considerations that must be taken into account when formulating U.S. international tax policy, it is questionable whether such an integrated approach is an independently attainable objective.

Even if Congress were able to take an integrated approach to formulating international tax policy and reduce internal complexity, only a portion of the overall complexity problem would be solved. Those experienced in the practical application of the U.S. international tax regime realize that it applies only to *cross-border* movements of capital and labor, movements that necessarily implicate the international tax regimes of other countries. The rules of these foreign regimes often conflict with the existing U.S. rules, thereby creating additional, external complexity. External complexity imposes significant costs on U.S. and foreign taxpayers, and for this reason, may render cross-border movements of capital and labor impracticable or even impossible. In addition, external complexity creates opportunities for tax arbitrage, the purpose of which is to drain one or more national treasuries of tax revenue.

The United States has already taken steps to mitigate the problems created by external complexity by entering into a broad network of tax treaties that coordinate the U.S. international tax regime with those of its treaty partners. Unfortunately, such concerted tax coordination at the international level has proved to be only a limited means of mitigating external complexity. This Article has explored the viability of pursuing tax coordination at the national level as well, by employing STC/Comparative Law as a framework within which the U.S. international tax regime might be reformed. The potential benefits of pursuing tax coordination at the national level include (i) simplification of cross-border transactions, (ii) increased certainty as to the legal treatment of cross-border transactions, (iii) reduction of the costs and delays of undertaking cross-border transactions, (iv) elimination of opportunities for tax arbitrage, and (v) reduction of information asymmetries. A potential cost of pursuing such coordination may be a reduction in efficiency. Nevertheless, the flexibility of the proposed framework (i.e., its ability to accommodate national political, economic, and social norms and allow for a measure of difference in international tax rules) allows a proper balance to be achieved between these potential costs and benefits. As demonstrated by the application of the proposed framework to the task of reforming the U.S. rules governing the tax treatment of cross-border charitable contributions, a collateral benefit of pursuing tax coordination at the national level may be a reduction in the existing level of internal complexity. In this concrete example, the proposed framework served to constrain the tendency of conflicting domestic policy considerations to produce internal complexity in the U.S. international tax regime.

Thus, by shifting from a national to an international perspective, a more holistic approach to reform is fostered, which may allow both the burdens created by the internal *and* external complexity of the U.S. international tax regime to be addressed and, perhaps, remedied.

* * *