



United States of America

Expert: Leslie Lenkowsky

Institutional Affiliation: Indiana University Lilly Family School of Philanthropy

With contributions from staff at the Indiana University Lilly Family School of Philanthropy

QUICK FACTS

Legal forms of philanthropic organizations included in the law: Association, Benefit Corporation, Foundation, Cooperative, Corporation, Limited Liability Company, Trust, Endowment, Society. Other(s): Political Organizations

Five main social issues addressed by these organizations: Higher Education, Primary and High School Education, Health and Medical Research, Basic Needs, Youth and Family

Average time established by law to register a philanthropic organization: Other: Not specified in law. Registration is a state function.

Average cost for registering a philanthropic organization: US \$0-\$125 (varies by state)

There is no standard fee. Generally, registration is inexpensive, though costs vary by state. Obtaining tax exemption is more costly, may require legal assistance and take several months. Organizations may also have to receive approval for fundraising in states, though this would be inexpensive.

Government levels primarily regulating the incorporation of philanthropic organizations: Central/Federal Government, State Government

State governments are responsible for incorporation of an organization. The Federal government usually grants tax-exemption and tax-deductibility status. However, state governments grant tax exemption from state taxes, such as sales and property tax, and may have their own rules for granting them.

Philanthropic Environment Scores:

Year	Ease of Operating	Tax Incentives	Cross-Border Flows	Political Environment	Socio-Cultural Environment	OVERALL SCORE
2018	4.8	5.0	4.5	4.5	5.0	4.77

I. Formation/Registration, Operations, Dissolution of a Philanthropic Organization (PO)

The three questions in this section pertain to the laws and regulations governing philanthropic organizations (POs). The scoring questions for this category cover three aspects of regulations: (A) formation and registration, (B) operations, and (C) dissolution.

Question 1: To what extent can individuals form and incorporate the organizations defined?

Score: 4.5

Americans generally have a considerable degree of freedom in forming POs, including Constitutional protection of “freedom of association.” People wishing to act collectively do not need to obtain legal recognition in advance, and hundreds of thousands of such “informal” groups are estimated to exist. Anyone can found one.

However, if one wishes to obtain legal recognition in order to, for example, own property or limit individual liability, then a PO needs to incorporate (usually at the state level, but for a few groups, at the Federal level) meeting a minimal set of requirements, such as having by-laws, a set of directors, and a legal purpose. There is no financial requirement. If a PO wishes to obtain special tax treatment, such as exemption from income or property taxes, it need to apply for approval by both Federal and state tax authorities. Although the process is well-established and approval is usually routine, it requires filing of documents, payment of fees, and legal assistance. Depending on the circumstances, the process can be costly and time-consuming. Moreover, the principal Federal agency involved, the Internal Revenue Service (IRS), has been under investigation since 2013 for allegedly applying partisan political criteria in considering applications for tax exemption.

POs that have received legal recognition have to file annual reports with both state and Federal agencies, which are made public. To promote increased transparency and public accountability, the amount of information sought on these forms has been increasing in recent years.

Depending on their legal status, POs may be prohibited from conducting activities that are permitted for other types of organizations. The largest group of tax-exempt organizations, “public charities” (501c3’s), are not allowed to take part in Federal election campaigns, for example (see Question 8). These rules are set by statute and administrative action, conveyed in writing. POs can pursue appeals through state and Federal courts.

Question 2: To what extent are POs free to operate without excessive government interference?

Score: 5.0

PO governing boards have broad authority over their organizations’ internal affairs, but are expected to comply with both statutory and common-law rules pertaining to directors of corporations, avoiding conflicts of interest, and acting prudently in making decisions about their corporations. Federal and state laws contain provisions that limit the discretion of directors in certain areas, such as in setting executive compensation. Directors who violate these rules can face legal liability, fines, and removal from office.

In several states, proposals have been made to regulate the structure of PO boards, such as by requiring more minority-group members. Some aspects of corporate governance laws, adopted in the wake of for-profit business scandals, also apply to POs (or are seen as practices worth adopting). These include conflict-of-interest, record-retention, and whistleblower protection policies.

Within generally applicable laws (such as criminal laws) and specific statutory limitations (see Question 1), POs have relatively few constraints on working with other groups, (or governments and businesses, or in using communications media, within the United States or outside it. However, American grant making organizations are required to establish a mechanism for the financial oversight of grants made to foreign POs, and supporting organizations considered to be engaged in terrorism is prohibited (See below). Laws aimed at regulating political spending and lobbying also impact the activities of POs, such as by preventing coordination with candidates for office. Philanthropic organizations that receive tax-deductible contributions may not participate in election campaigns and need not disclose donors (see Question 8).

Many governance rules are long-established and, generally clear and understood. However, enforcement is often sporadic and unpredictable. In addition, various non-governmental groups may set "best practices" that differ from those required by law.

Question 3: To what extent is there government discretion in shutting down POs?

Score: 5.0

In the United States, governing boards can dissolve POs, following procedures in by-laws (or state incorporation laws). At dissolution, the net assets owned by the organization (such as property or investments) must be made available for use by another PO, rather than distributed to directors, stockholders, or members. State laws may set rules (including procedures for valuing assets). Since POs are generally not required to report when they go out-of-business, accurate data on the extent of voluntary terminations are hard to come by.

State officials—typically, the Attorney General—usually have the power to dissolve POs in their states for failing to comply with the requirements of incorporation laws. They can also take remedial steps, such as replacing an organization’s governing board. These actions generally require approval by a state court.

At the Federal level, the IRS has the authority to revoke an organization’s tax exemption, which could lead to its termination. It also can impose financial penalties for violations, generally known as “intermediate sanctions.” Although the IRS can take these actions administratively, POs have the right to appeal them to Federal courts. Court rulings in these matters are typically treated as private ones, conveyed only to the affected organization.

Involuntary termination or other kinds of remedial actions by state or Federal authorities occur infrequently. Whether this is because misconduct is infrequent, or because enforcement agencies have typically been under-staffed and under-funded, is unknown. Efforts to ascertain the extent of problems among POs, such as IRS audits of salaries paid by large foundations, have usually found a low incidence of problems, though journalistic accounts that allege wrong-doing are more

extensive.

Hybrid PO's, for example B Corporations, follow the rules of for-profit corporations when dissolving, including paying creditors if bankrupt.

II. Domestic Tax and Fiscal Issues

The two questions in this section pertain to laws and regulations governing the fiscal constraints of giving and receiving donations domestically.

Question 4: To what extent is the tax system favorable to making charitable donations?

Score: 5.0

Donors to POs recognized by tax authorities as charitable and having broad public support – such as, exempt as “public charities,” which constitute a majority of tax-exempt groups – can deduct the amount of their cash or in-kind gifts from their Federal income tax liability. However, donors to other types of tax-exempt organizations, for example, labor unions or political action committees, cannot do so. Moreover, only taxpayers who itemize their deductions, which is less than one-third of all households, are eligible to claim this deduction, whose value is reduced for taxpayers with large totals of itemized deductions. Gifts to “public charities” provided for in wills, known as “bequests,” are fully deductible from estate taxes.

States and localities differ in how they treat charitable gifts. Some follow Federal rules; however, in some states, donations only for particular kinds of POs (such as colleges or universities in the state, or organizations helping the needy) are deductible, or may be eligible for a credit against income tax liability, up to an amount specified in state law. Some states allow tax-exempt organizations to sell goods or services without collecting sales taxes from purchasers; while others do not. Some waive sales tax collections only for certain types of transactions. All jurisdictions allow owners to deduct the value of property donated to “public charities,” often at current market-value, not purchase-price.

The maximum value of Federal tax deductions depends on the donor's taxable income. The higher the tax bracket, the more valuable the deduction, which has led to repeated, but so far unsuccessful, efforts to “cap” it. Individual donors may deduct no more than 50 percent of their incomes (10 percent for businesses). Additional rules apply to gifts of capital or to private foundations. Excess deductions can be carried over to future years. The process for claiming deductions is well-established, but donors are expected to be able to verify the amounts they claim.

In December 2017, the Congress passed the Tax Cuts and Job Act that includes several changes that may affect charitable giving. The changes include a decrease in the top marginal tax rate and increase in the standard deduction and estate tax exemption for individuals and couples; a decrease in the top marginal tax rate for corporations; and a limit on state and local income, sales and property tax deductions. The effects of these changes on individual and corporate charitable giving are interrelated and influenced by economic, policy, and behavioral factors; therefore the full impact of the tax reform on charitable giving remains uncertain. Tax policies affecting foundations and donor-advised funds were largely unchanged.

Question 5: To what extent is the tax system favorable to POs in receiving charitable donations?

Score: 5.0

POs can apply for exemption from Federal tax on net corporate income. The IRS approves most applications, usually within a few months, with minimal legal assistance required. However, in exchange for tax exemption, the organizations have to abide by a variety of rules, ranging from annual reporting requirements to limits on executive compensation and commercial income. However, like other corporations, POs have to collect Federal payroll taxes if they have paid employees. Private foundations are also required to spend a certain amount of their assets each year and to pay a tax on their net investment income.

Organizations exempt at the Federal level will generally receive exemption from state and local corporate income taxes as well. In addition, POs can receive exemption from paying state or local taxes on property they own and sales taxes on purchases they make. The coverage and requirements for these exemptions vary across jurisdictions. Moreover, some state or local governments, expect, and sometimes require, POs to provide certain kinds of services, for example, charity care by hospitals, or make “payments in lieu of taxes” (PILOT’s), in an amount related to the tax the organization would pay if it were not exempt. Others may be required to pay “user fees” for government services, such as police and fire protection.

Private donors can support any PO. However, if they wish to claim a tax deduction, their gifts must go to “public charities” (see Question 4). Without permission of the IRS, private foundations can make grants only to “public charities.” Private donors also financially support POs in a variety of other ways besides gifts, including membership dues, loans, purchase of goods or services, and capital investments, some of which lead to deductions.

Hybrid PO’s, such as B Corporations, are not tax-exempt and must show they serve a social purpose to retain their status, which affects their legal relationships with their investors.

III. Cross-Border Philanthropic Flows

The two questions in this section concern laws and regulations governing the fiscal constraints of giving and receiving cross-border donations. The scoring for these questions pertains to the donor and receiving entities.

Question 6: To what extent is the legal regulatory environment favorable to sending cross-border donations?

Score: 4.0

Americans can give cross-border donations without prior government approval, but they can obtain a charitable tax deduction only for contributions to POs “created and operated” in the United States. However, they may be able to exclude such gifts from taxable income, if they can show that the cross-border organization would qualify as a charity in the United States. Private foundations may count cross-border donations toward the amounts they are required to give annually by following

complicated procedures aimed at ensuring their gifts are used for activities that would be considered charitable in the United States.

Americans can claim charitable tax deductions for gifts to US-based organizations, such as churches or humanitarian groups, which operate in foreign countries, but these groups must comply with IRS rules regarding how the gifts can be used, although they can make payments directly to needy individuals as part of a “qualified” disaster relief effort. Separate sets of rules apply to cross-border giving by corporations and from trusts or bequests.

Many foreign organizations have established “public charities” in the United States to enable American donors to make tax-deductible contributions. Some have also registered with the IRS. As a result, much of American giving abroad occurs through US-based organizations.

Since 2001, Federal policies have tried to prevent charitable contributions from being used to finance terrorist activities. A 2010 decision by the U.S. Supreme Court (Holder v. Humanitarian Aid) upheld the constitutionality of these policies, including the prohibition of gifts to organizations on a list of suspected terrorist groups, maintained by the U.S. Department of State, even if the funds are earmarked for a group's charitable work. These rules have generally required donors to exercise greater diligence in making international gifts, or face penalties, and have been accused of reducing giving, especially to the Middle East.

Question 7: To what extent is the legal regulatory environment favorable to receiving cross-border donations?

Score: 5.0

Like gifts from Americans, gifts from foreign sources, such as bequests or donations from trusts, are not considered taxable income in the United States and do not need government approval. However, gifts from foreign sources exceeding US \$100,000 (or a lesser amount if from a foreign corporation) must be reported to the IRS. In addition, regulations of the U.S. Treasury Department require reporting when cash exceeding US \$10,000 is brought into the United States by plane, mail, wire, or in other ways.

If a foreign (or nonresident alien) donor earns income in the United States, gifts to American POs can be deducted from American income taxes to the extent allowed by law. Little information about donations from foreign sources to American charities is available. The IRS has reported an increase in foreign trusts established by Americans, some of which may make payments to United States charities, as do American foundations domiciled offshore (such as Atlantic Philanthropies).

Tax treaties, such as those with Mexico, Canada, and Israel, may allow donors in other countries to deduct their gifts to American charities from tax liabilities in their own countries. International agreements, such as those dealing with donations of “cultural property,” may also restrict the ability of foreign donors to contribute certain kinds of gifts (such as cultural artifacts) to American organizations.

Campaign finance laws in the United States prohibit citizens of another country from providing support for Federal elections. They do not affect the ability of non-citizens to support groups engaged

in election-related activity, such as public education. Foreign-owned corporations with American subsidiaries can also contribute to candidates through political action committees created by their subsidiaries. Foreign support for the work of the Clinton Foundation – a "public charity" in the U.S. – became an issue in Hillary Clinton's 2016 presidential campaign.

IV. Political and Governance Environment

The three indicator questions in the next two sections concern the political and governance context, socio-cultural characteristics, and economic conditions that influence the environment for philanthropy.

Question 8: To what extent is the political and governance environment favorable for philanthropy?

Score: 5.0

American government gives POs wide opportunities to participate in government. Sometimes, as with pending regulations, their comments may be sought or required. At others, they may participate in various ways in legislative deliberations, court cases, and in other activities of government. They may mobilize citizens to "petition for redress of grievances," protest government actions, form movements for social change, or engage in civil disobedience. By delivering public services, they may implement government policies, adapt them to different constituencies, or even replace them. POs often serve as a source of ideas and people for government, and vice versa. If receiving tax-deductible gifts, POs may not take part in partisan elections.

However, for many years, there has been concern that the American political system is becoming less functional and this is blamed in part on the "gridlock" of interest groups, many of which are POs. Also, there have been complaints that POs have become more dependent on a smaller section of the population, those with the resources of money, time, and other things to participate in them. Out of choice, or because they are unaware of their abilities to do so, many POs do not participate in American government.

POs are facing greater challenges in participating in government, partly because of slow growth in philanthropic funding, changes in public funding patterns (toward supporting individuals rather than service-providing organizations), increased dependence on earned income (and the need to avoid controversy), and lower levels of membership. Some worry that the greater dependence of POs on very wealthy donors is bad for American democracy, but the evidence is debatable. Political tensions between the government and POs are accepted and, indeed, seen as evidence of political health. Following the 2016 election of Donald Trump as U.S. President, POs critical of his policies saw increased donations.

Question 9: To what extent are public policies and practices favorable for philanthropy?

Score: 4.0

American government plays a small role in encouraging a culture of POs, mostly through elementary and secondary schools, which sponsor a wide range of clubs and other extra-curricular

organizations. Students may receive academic credit for participating in these, or improve their prospects for further schooling or jobs. Schools also offer education in “civics,” “problems of democracy,” and in service-learning (combining instruction in a subject with opportunities to apply it through the work of a PO). Hundreds of colleges and universities offer some level of instruction in nonprofit management, philanthropic studies, and related subjects. Several specialized publications report regularly on philanthropy in the United States, and stories appear frequently in general-interest publications and on broadcast media.

Public officials at all levels of government encourage giving and volunteering in speeches and other public events. There are a few government agencies specifically responsible for providing support for POs, other than incidentally through their normal programs, such as in the arts and humanities. A small federal agency, the Corporation for National and Community Service, operates a national service program, whose aim includes promoting greater civic engagement. The Census Bureau conducts an annual survey of volunteering in the United States. Some states and cities also have programs, or assign officials, to promote or coordinate the work of POs, but for the most part, building a culture of philanthropy is left in private hands in the United States: families, religious bodies, existing POs, groups of donors like those in The Giving Pledge, etc.

The government generally supports nonprofits on a competitive basis. Capacity-building efforts are irregularly undertaken, both privately and publically. Eligibility is broad except for religious groups. Donors are free to support charities, though politics has sometimes been a factor in making gifts.

V. Socio-Cultural Environment

Question 10: To what extent are socio-cultural values and practices favorable for philanthropy?

Score: 5.0

Philanthropic activity has been highly respected and widely practiced. Upwards of 67 percent of American households make donations annually. Contributions amount to more than one in fifty dollars of national income, the highest share in the world. Twenty-five percent of Americans report volunteering their time to charitable groups, not including informal volunteering, such as helping neighbors.

Philanthropic activity in the United States can be traced to the attitudes of early settlers in the 17th century. Since then, many observers have noted the expectation that Americans should be actively involved in charitable and other kinds of community-serving activities, and have seen it as an important factor in the maintenance of American democracy and “American exceptionalism,” or what makes the United States different from other countries.

Key factors impacting philanthropic activity in the United States have been: widespread religious affiliation; a public philosophy favoring a limited role for government; and family and community networks (“social capital”) that have engaged new generations (and immigrants) in civic organizations. Although it has played a supportive role, public policy, such as the deductibility of charitable contributions, has also had an effect.

Although still in higher esteem than other parts of society, such as the government, POs are less well-regarded in the United States than they were one or two generations ago, because of well-publicized scandals involving charitable groups, declining religious affiliation, increased government (and commercial) activity in areas POs once worked alone, and lower rates of volunteering, especially among young people.

Giving has now recovered the ground lost during the 2007-2009 recession. The number of POs continues to grow, and hybrid POs, such as B Corporations, have attracted increased attention. Foundations and other organizations remain active internationally. Always involved in POs, women and minorities have become more active.

VI. Future of Philanthropy

These questions are used to provide a general picture of the future of philanthropy in this country as well as recommendations to improve the philanthropic environment.

Current state of the philanthropic sector

Philanthropic activity in the U.S. continues to be growing and diversified in a variety of ways. But it is, as always, facing challenges. While a large share comes from institutional donors, most (more than 75 percent) comes from individuals. The number of POs registered with the IRS has risen, but significant numbers of non-registered organizations (over 300,000) also exist. The proportion of American adults who volunteer has remained at about 25 percent, but this does not include volunteering informally (e.g., for neighbors). Despite proposals to cap deductibility for giving, no legislative changes appear to be on the horizon. Very wealthy Americans are investing their resources in philanthropy at younger ages, and not only in foundations. Entrepreneurs are also starting various kinds of “social businesses.” Hundreds of colleges and universities sponsor programs to prepare future professionals for jobs in POs, but surveys also show strong interest among young people broadly for working in their communities. Volunteers far outnumber professionals in POs, who are mainly found in the largest organizations.

A variety of infrastructure organizations, such as Independent Sector, Grantmakers for Effective Organizations, and the United Way of America, encourage giving and foster capacity-building in philanthropy. So do consortia of organizations behind special events, such as “Giving Tuesday,” which promotes donations after Thanksgiving. However, most donations are generated by the groups receiving support, aided by a well-established fund-development profession.

Criticisms are often heard that philanthropy is too multi-faceted, that too many organizations are chasing after too few funds, and that because of inadequate coordination and evaluation, donations of time and money are ineffective. Although they have led to extensive self-examinations within philanthropy (and changes in practice, including extensive collaborations with other POs, with the government, and with business), the government has not taken steps to restrict the autonomy of philanthropy, relying instead on encouraging more transparency and better self-governance. Denials of legal recognition for POs are rare and, in many cases, controversial.

Three major recent events affecting the philanthropic landscape between January 2014 and December 2016

- Continuing and unresolved investigations of the Exempt Organizations division at IRS (began in 2013);
- Election of Republican President and Congress in 2016; and
- Creation of Chan Zuckerberg Initiative as an LLC, not a PO, in 2015.

Future development trends in the philanthropic landscape

PO's face a variety of external and internal challenges.

1. Weak economic growth: Before 2017, the American economy had grown relatively slowly, lowering both the growth-rate of current giving and the size of the long-anticipated transfer of accumulated assets from "baby boomers" to their heirs, some of which was expected to be available for philanthropy.
2. Straitened government finances: Downward pressures on government budgets reduce funding available for both programs involving PO concerns and entitlement programs for individuals, who might otherwise seek philanthropic services.
3. Legislative actions: Major tax reform has been enacted and changes in health care, immigration, food assistance, and other areas of public policy are under discussion, all of which could impact philanthropy.
4. Business expansion: The growth of service businesses in health, education, and elsewhere increases competitive pressures on nonprofits. Technological and financial innovation challenges POs in operational and economic ways.
5. "Globalization:" For POs operating in the international arena, retrenchment in "globalization" could increase program difficulties.
6. Changing preferences for philanthropy: Long-term declines in religious affiliation and membership in associations ("bowling alone") could lead to reductions in philanthropic activity.
7. Development of new forms of philanthropy: Heightened interest, especially among the newly wealthy, in new ways of addressing social problems through LLC's or other organizations could weaken interest in more traditional ones, such as foundations.
8. Increased politicization: Greater involvement of POs in electoral politics, coupled with perceptions of favoritism for one or another side, create the potential for official actions limiting their autonomy.

9. Uncertain regulatory framework: IRS upheaval, demands for better “accountability,” accusations of mismanagement, and new forms of philanthropic and political activity could lead to revisiting the legal framework for POs.

Three key recommendations to improve the environment for philanthropy

- Foster higher rates of economic growth;
- Nurture “social capital;” and
- Renegotiate “public-private partnership” and regulatory framework for POs in the United States.