



Dual-Qualified Charitable Structures

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DUAL-QUALIFIED CHARITABLE STRUCTURES: A Tax-Efficient Solution for Giving in the US and UK

Americans resident in the United Kingdom have particular income tax problems with respect to structuring tax-efficient charitable gifts because they are subject to two systems of tax. In the past Americans typically chose either to obtain tax relief in the United States or the United Kingdom and accepted that the overall benefit would be limited by the constraints of the other tax system.

In particular, a US taxpayer resident in the UK found it difficult to obtain US tax relief on a gift to a UK charity and UK tax relief was not available for gifts to a US charity. This problem arose because of the limitations imposed under the tax and charity rules in the US and the UK. However, there is a solution for such taxpayers in the form of a dual-qualified structure, which secures a charitable income tax benefit in both the US and the UK.

Tax Issues for US Taxpayers

US citizens are subject to US income tax on a worldwide basis regardless of the place of residence of the taxpayer. An individual donor can benefit from a charitable income tax deduction only if the recipient organization is created or organized in the US or under the laws of any US state or the District of Columbia. This requirement is not imposed for US gift and estate tax purposes. In order to meet this 'organization test' if an entity is a trust it should be governed by US law, and if it is a corporation, it should be incorporated within the US.

Qualification for UK Income Tax Benefits

In the UK, income tax relief for a charitable gift is divided between the charity and the donor. This means that under the Gift Aid provisions a gift by a UK resident to a qualified charity with the appropriate Gift Aid declaration entitles the charity to recover basic rate income tax deemed to have been deducted by the donor when making the gift.

If a higher rate taxpayer, the donor is entitled to recover higher rate tax with respect to the same gift. This means that tax relief is granted in full but the relief is divided between the charity and the donor and the amount to be paid by way of such a gift needs to be calculated carefully.

In order to be eligible for Gift Aid relief the gift must be made to a charity which is organized in the UK and governed by English, Scottish or Northern Irish law, or to equivalent organizations in the EU, Norway and Iceland (in accordance with EU law).

Securing the Income Tax Deduction in Both Countries

It can be seen that the interaction of these rules places a US citizen resident in the UK (or any other taxpayer who is subject to both US and UK tax on his income) in a difficult position.

For example, a gift to an English law charity (or equivalent organization in the EU, Norway or Iceland) would qualify for a UK income tax relief through the Gift Aid procedures. This means that the donor's income will effectively be reduced by the amount of the gift and the UK tax associated with the amount of the gift will be relieved. However the donor's gift to the English charity will not qualify for a US income tax deduction because the English charity will by definition not be organized under the laws of a US state. Therefore, although the donor's income has effectively been reduced for UK income tax purposes, no deduction is available for US income tax purposes. This means that the effect of the gift may be to increase the donor's US income tax liability because his UK tax (and therefore his US foreign tax credit) will have been reduced.

It is of course open to the donor to make a gift to a US exempt organization, but if the donor's primary income is UK source, this may mean that he or she has only a small residual US tax liability after the foreign tax credit relief. This means that his ability to claim a deduction in the US will be very limited and therefore the donor may effectively receive no tax relief on a gift to a US charity.

Dual Qualified Corporate Structure

In order to secure effective income tax relief for a donor who is subject to both US and UK income tax, it is necessary that a charity should simultaneously be governed by English and US law. This problem can be solved with a dual corporate structure where a US non-profit organization owns all of the share capital of an English charitable company and the necessary US tax election is made.

The key to this structure is the use of the US entity tax election. Whereas for UK tax purposes an entity will be generally classified as a company if it is registered under the Companies Act the position was more complex in the United States. In 1997 the US Internal Revenue Service simplified the US rules with an election procedure so that an eligible entity can make an election and file this with the Internal Revenue Service so as to determine whether it should be treated as a company or as a partnership for US tax purposes (popularly known as the 'check the box' rules).

Based on these rules, a corporate structure can be used whereby a US exempt organization incorporates an English charitable company with a share capital. The share capital is wholly owned by the US exempt organization. The English company makes an election to be treated as a disregarded entity for US tax purposes. The English charitable company is registered as a charity with the Charity Commission and simultaneously qualifies as a foreign branch of the US exempt organization.

The effect of this election is that a gift to the UK subsidiary of a US charity made by a donor who is subject to both US and UK income tax is eligible for income tax benefits in both the US and UK.

- For UK tax purposes, the gift is to the English charity and is therefore eligible for Gift Aid relief.
- For US tax purposes the gift to the UK disregarded entity is treated as a gift to a US qualified exempt organization that will give rise to a US income tax deduction.

Shares and Securities

The dual qualified structure can be used for gifts of shares and securities although careful consideration needs to be given as to the exact mechanics for the gift. Individual taxpayers may prefer to make gifts either in the United States or in the United Kingdom.

Gifts by Will

Donors interested in a charitable legacy can use the dual qualified structure in order to ensure that the gift is tax effective both for UK inheritance tax purposes and for US estate tax purposes. However, it may be equally tax efficient for the legacy to pass directly to the UK charity since most UK charities will be recognized for purposes of the US estate tax deduction which does not require the same 'organization test' to be passed as is required to obtain an income tax deduction.

Europe and Asia

Due to the recent expansion of UK charitable tax reliefs into the European Union, a US-UK dual qualified structure now has even more potential to provide an internationally tax-efficient structure across multiple jurisdictions, moving in some cases to a 'multi-qualified' structure. In addition to this European opportunity, there may be opportunities to gain local recognition in Asian jurisdictions such as Hong Kong to widen the scope of efficient fundraising and giving even further. Unfortunately Brexit has complicated this in that residents of EU countries will no longer be guaranteed local charitable benefits when donating to a UK charitable organization.

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