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When Must a Foreign Charity File a Form 990?

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Years ago I wrote a long article about foreign charities.[1] At the time, I was frustrated at the IRS's lack of understanding of the Code's rules governing foreign charities; as became evident, the problem is that no one in the Internal Revenue Service international group knows much about §501(c)(3),[2] and no one in the exempt organizations group knows much about the international tax rules. Twenty-plus years later, these problems persist.

Exemption for Organizations "Described in" §501(c)(3)

An organization described in §501(c)(3) is generally exempt from U.S. tax. Such an organization may be formed under U.S. or foreign law; unlike some other subsections of §501, it does not require that the organization be domestic in order to qualify for exemption from U.S. tax. The main difference between a foreign and a domestic charity is that contributions to a foreign charity are not deductible under §170.

Various rules in the Code and the regulations give effect to this exemption. For example, if a foreign charity receives U.S.-source "fixed or determinable annual or periodical income" ("FDAP income") otherwise subject to withholding tax under §1441, it will be able to provide a Form W-8EXP to the withholding agent claiming the benefit of its exemption, so long as it is described in §501(c)(3) and otherwise complies with the requirements of Reg. §1.1441-9. As another example, Rev. Proc. 92-94[3] sets out the rules to be followed for a foreign charity to satisfy a U.S. grantor organization that the foreign charity is described in §501(c)(3) and is not a private foundation. This procedure is generally followed by counsel in delivering the opinion required by the withholding regulation.

Section 1443(a) authorizes the IRS to require withholding of U.S. tax on items of unrelated business taxable income (UBTI) of a foreign charity, and regulations have done so. Otherwise, the exemption applies to all income of the foreign charity, including "effectively connected income" (ECI), exactly as if the foreign charity were a domestic one. Examples of such types of income include FIRPTA gains[4] and ECI earned in connection with the foreign charity's exempt purposes. If the ECI is earned through a partnership, the regulations under §1446 provide that no withholding is required if the foreign partner is described in §501(c)(3) and the income is not UBTI. The regulations follow the same basic documentation

[1] Blanchard, *U.S. Taxation of Foreign Charities*, 8 Exempt Org. Tax Rev. 719 (Oct. 1993), *adapted and reprinted in* NYU School of Law, Program on Philanthropy and the Law, Conference, International Giving: Policies and Regulation (Oct. 1995); 2 Alli@nce 64 (May 1997).

[2] All section ("§") references are to the U.S. Internal Revenue Code, as amended (the "Code"), or the Treasury regulations thereunder, unless context indicates otherwise.

[3] 1992-2 C.B. 507.

[4] The Foreign Investment in Real Property Tax Act of 1980 regulations establish the procedure for claiming the tax exemption. Reg. §1.1445-6(b)(2)(ii).

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requirements that are set out in the §1441 regulations.[5]

Most domestic organizations described in §501(c)(3) are required under §508 to provide notice to the IRS and obtain an ''IRS letter'' recognizing their exempt status; this is accomplished by filing a Form 1023. However, the notice requirement does not apply to most foreign charities. Section 4948(b) provides that a foreign charity need not comply with §508 unless it derives a significant portion of its support from U.S. sources.[6] Regulations under §4948 provide that the §508 notice requirement applies only if the foreign charity derives more than 15% of its support from U.S. sources. Thus, a foreign-supported foreign charity is exempt from U.S. tax without regard to whether it has filed a Form 1023 and received an IRS letter acknowledging that it is described in §501(c)(3). It makes sense not to require a foreign-supported foreign charity to apply to the IRS for recognition of its exempt status, given that the principal source of its support is foreign and donations to it are not deductible.

Filing Requirements

Although the Code is clear that a foreign-supported foreign charity need not obtain an IRS letter evidencing its exempt status, the Code is not at all clear on the question presented by this commentary — namely, whether such a charity is required to file a Form 990. It would be logical to conclude that if a foreign charity is not subject to the notice requirement of §508, it is not required to file a Form 990. Yet §6033 requires ''every organization exempt from taxation under section 501(a),'' which includes organizations described in §501(c)(3), to file a Form 990 annually with the IRS as regulations may require. The regulations under §6033 do not provide any exemption from filing for foreign charities.

The regulations under §6033 clearly contemplate that donations to the filing charity would be deductible, and that the filing charity must apply for an IRS letter. They thus clearly assume that the charity in question is domestic. Reg. §1.6033-2(c) contains a specific rule for a charity whose exempt status has not yet been ''recognized'' by the IRS. Since a foreign-supported foreign charity is never required to have its exempt status recognized by the IRS, this rule makes no sense as applied to foreign charities.

If §6033 were applied literally, every foreign organization described in §501(c)(3) would be required to file a Form 990 with the IRS, even if it has no U.S. income, activities, or donors. Moreover, any foreign charity that had been in existence for more than three years but had not filed a Form 990 would have had its exemption auto-revoked under §6033(j).[7] It seems obvious that this cannot be the rule; among other things, it would vitiate the exemption from FDAP, a result nowhere hinted at in the §1441 regulations.

In fact, the IRS has indicated in response to questions from practitioners that it does not want a Form 990 from a foreign charity that does not have an IRS letter, and would not know what to do with such a return if it were filed. Probably in response to this, some practitioners take the view that the words ''exempt from taxation'' used in §6033(a) are intended to cover only charities that have IRS ruling letters. They point to the fact that this language is different from the ''described in'' language of §501(c)(3) itself.

In 1991, the IRS issued a private letter ruling to a foreign-supported German charity that in a previous year had voluntarily applied for recognition of its exempt status using a Form 1023, even though it was apparently not required to do so. The IRS noted the fact that §4948(b) does not require a foreign-supported foreign charity to apply for recognition of its exempt status, but ruled that by voluntarily submitting the Form 1023, the charity ''surrendered itself'' to the rules governing charities, including the requirement that it file Form 990 in each year of its existence.[8] Once triggered by the voluntary filing of a Form 1023 and the receipt of an IRS letter, the IRS's position as stated in the private ruling is that the foreign charity must continue filing the Form 990 each year thereafter, even long after it ceases to have any connection to the United States and even though contributions to the foreign charity are not deductible. According to IRS policy, there is no exit, except for the wholly unsatisfactory one of affirmatively ceasing to be described in §501(c)(3) (e.g., by being operated for a non-exempt purpose).

The 1991 private letter ruling does not cite any authority, even §6033, for the proposition that the German charity was required to file a Form 990. It was simply taken as a given. The ruling also assumed that if the German charity had *not* applied for recognition of its exempt status, it would not have been required to file a Form 990. The only inference one can draw from this is that the author of the ruling believed that the obtaining of an IRS letter is the trigger for a foreign charity becoming subject to §6033.

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[5] Reg. §1.1446-3(c)(3).

[6] One probable cause of the confusion over foreign charities is the odd placement of the §508 exemption in Chapter 42A of the Code, dealing with private foundations. While §4948(b) exempts all foreign-supported foreign charities (whether or not private foundations) from the private foundation notice rules of §508(e), it also exempts such foreign charities from the whole of §508.

[7] Under §6033(j), the penalty for failure to file Form 990 as required is loss of the organization's exemption.

[8] PLR 9141050. The ruling actually used the phrase in quotes.

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The private letter ruling also assumed, without explanation, that a foreign charity will simply *not be exempt from tax* unless it secures an IRS letter. The ruling stated: ''Organizations described in §501(c)(3) are afforded an opportunity *to choose* whether they will be treated as exempt. They may avoid such treatment simply by failing to file the necessary application'' (emphasis added). To the extent that this language can be read to suggest that tax exemption turns on whether a Form 1023 is filed, it is wrong.

The 1991 ruling noted that the IRS was studying whether it should provide exemption from the §6033 filing requirement for foreign organizations that do not receive U.S. income. A few years later, the IRS issued Rev. Proc. 94-17[9] to do just that; that revenue procedure has since been superseded by Rev. Proc. 2011-15.[10] Rev. Proc. 94-17 at least solved the problem confronted by the German charity in PLR 9141050 by providing that no filing is required where a foreign charity's U.S. gross receipts are less than $25,000. However, while it increased the U.S. gross receipts threshold from $25,000 to $50,000, Rev. Proc. 2011-15 requires a foreign charity falling below that threshold to file the ''postcard'' Form 990-N.

Although Rev. Proc. 2011-15 refers to the regulations under §4948 for purposes of measuring a foreign charity's U.S. receipts, it makes no mention of §4948(b) or a foreign charity's exemption from the §508 notice requirement. The revenue procedure makes no distinction between a U.S.-supported foreign charity that is required to obtain IRS recognition of its exempt status and a foreign-supported foreign charity that is not required to do so. It simply states, in §3.04, that if the $50,000 threshold is exceeded, ''the organization is required to file an annual return on Form 990.''

Thus, the current guidance from the IRS under §6033 seemingly requires every foreign charity in the world to either: (1) file a Form 990 if its U.S.-source gross receipts are in excess of $50,000; or (2) file a Form 990-N in all other cases. Again, this cannot be the rule.[11] If the drafter of Rev. Proc. 2011-15 believed that, that revenue procedure applied only to foreign charities that had secured an IRS letter, this should have been clearly stated.

Practical Considerations

In practice, I believe, most foreign-supported foreign charities take the view that they are not required to file Form 990 if they are not required to obtain, and do not have, an IRS letter. This position is similar to that taken in the 1991 private letter ruling, but without its erroneous assumption that such a foreign charity could never be exempt. And in light of the 1991 ruling, most advisors advise a foreign charity not otherwise required to obtain an IRS letter not to do so, lest it become subject to the requirement of filing Forms 990 forever.

So, suppose you have a foreign charity as a client, and have concluded that it is not subject to §508. You have therefore advised it that it does not have to apply for and obtain an IRS letter. But now suppose that, in the current year, your client will earn ECI that is not UBTI and not covered by the FDAP rules.[12] Does it need to file anything at all with the IRS?

As noted above, if the ECI is gain from the sale of a U.S. real property interest, the FIRPTA regulations establish the procedure for claiming the tax exemption. If the ECI is earned through a partnership, the regulations clearly provide that no withholding is required if the foreign partner is described in §501(c)(3) and the income is not UBTI.

If the foreign charity directly earns other ECI exempt from tax by reason of §501(c)(3), then there is no withholding tax under the Code — and no rule, apart from Rev. Proc. 2011-15, addresses the foreign charity's filing requirements. Although the conservative course in this case might be to file a Form 990, this can be a fairly burdensome exercise and for the reasons noted above, it is not clear that it is actually required. Moreover, given the confusion at the IRS about the tax rules applicable to foreign charities, it is likely that once a foreign charity files a Form 990, for whatever reason, the IRS will insist on its filing at least a Form 990-N forever. For that reason, it may be the wisest course not to file any Form 990 in these circumstances.

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[9] 1994-1 C.B. 579.

[10] 2011-3 I.R.B. 322.

[11] Very recently, the IRS left a similar issue unresolved in the context of new temporary regulations under §506, apparently assuming that the only foreign organizations that would be subject to that rule are those that are contemplating applying for an IRS letter. *See* T.D. 9775, 81 Fed. Reg. 45,008 (July 12, 2016).

[12] ECI that is also UBTI would be subject to withholding under §1443(a). Assume that in the following discussion the ECI is not UBTI, for example, because it is derived in the conduct of the charity's exempt purpose, is gain taxed under §897 (FIRPTA), or for some other reason.

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