

CHANGING OUR APPROACH TO CHANGING THE WORLD:

Encouraging and Enhancing American Engagement in
International Philanthropy Through Tax Law Reform

Joseph E. Miller, Jr.



1st ed. 2013

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Published by Council on International Law and Politics
411 North LaSalle Street
Suite 200
Chicago, Illinois 60654
<http://www.cilpnet.org>

Publications Coordinator: Frank Emmert
Cover design: Salma Taman
Cover art: Cover photo taken in Gudele, South Sudan, by Barry Rodriguez.
For more information, see www.barryrodphotography.com
Font: Myriad Pro

Printed by CreateSpace

12 11 10 9 8 7 6 5 4 3 2 1

ISBN: 978-0-9858156-3-9

Table of Contents

Acknowledgments	9
Introduction: Crossing Borders to Bridge the Gap	11
American Philanthropy and its Legal Framework	11
Stopping at the Water's Edge? The Need for More and Better International Philanthropy	12
Overview of Analytical Structure	13
Chapter One: A Brief Overview of the Philanthropic Sector in the United States	16
I. A Profile of American Philanthropy	16
II. Legal Context: Where the Philanthropic Sector Fits	17
III. Choice of Entity Considerations for Charitable Organizations	18
Chapter Two: An Analysis of Legal Frameworks that Affect Philanthropy in the United States	21
I. Overview	21
II. Rationales for Federal Tax Exemption: Political Economy Carries the Day	22
III. Detailed Analysis of Laws Affecting Philanthropic Giving	23
1. General Requirements and Restrictions under Code Section 501(c)(3)	23
a. The private inurement prohibition	24
b. Organizational and operational requirements and the "commensurate test"	24
c. The limitation on lobbying	26
d. The absolute bar on political campaign activity	27
e. A note on "action" organizations	28
2. Other Laws of General Applicability to Exempt Organizations	28
a. The tax on unrelated trade or business income	29
b. Procedural requirements for obtaining exemption	31
c. Public reporting and disclosure requirements for exempt organizations	33
d. State-level regulation of solicitations by charitable organizations	35
e. A note on exemptions from state and local taxes	36
f. Concluding thoughts on laws of general applicability	37
3. Private Foundations v. Public Charities: Why the Distinction Matters for Philanthropy	38
a. Functionally based public charity classifications: churches, schools, and hospitals	39
b. Organizations demonstrating broad public support	40
c. Supporting organizations	42
4. Private Foundations: Regulated but Empowered Philanthropy	44
a. The tax on net investment income	45
b. The minimum payout requirement	45
c. Taxable expenditures	46
d. The prohibition on self-dealing	49
e. The excess business holdings prohibition	50
f. The prohibition on jeopardy investments	51
g. Additional private foundation rules	52

5.	Deductibility of Charitable Gifts by Individuals and Corporations	53
a.	Introduction to the deductibility rules	54
b.	The documentation requirements associated with deductibility	55
c.	The percentage limits on deductibility for charitable gifts by individuals and corporations	57
d.	Valuation rules for contributions of property	58
e.	Current proposals to limit deductibility	58

Chapter Three: United States Legal Frameworks Affecting International Philanthropic Giving

	Philanthropic Giving	62
I.	The General Disallowance of Individual and Corporate Income Tax Deductions	63
1.	Restrictions on Deductibility for Individuals	63
2.	Restrictions on Deductibility for Corporations	65
II.	International Grants by Private Foundations	66
1.	Introductory Overview of the Legal Framework	66
2.	Making an Equivalency Determination	67
a.	The “reasonable judgment”	68
b.	The “good faith determination”	68
c.	Tying it all together: making reasonable judgments and good faith determinations using “currently qualified affidavits”	69
3.	The Role of Expenditure Responsibility	71
4.	Other Contemporary Legal Factors Affecting International Grant Making by Private Foundations	72
a.	The problems of terrorism and illicit activities in international philanthropy	73
b.	International program-related investments for private foundations	74
III.	Charitable Gifts to United States Charities for Foreign Use	76
IV.	Concluding Thoughts on United States Laws Affecting International Philanthropy	79

Chapter Four: General Policy Matters Affecting Domestic International Philanthropy

I.	General Policy Issues Affecting Philanthropy	82
1.	Personal Motivations for Charitable Giving	82
2.	Political Ideology and the Role of Philanthropy	84
II.	Moving Abroad: Ideology and Politics; Perceptions and Realities	85
1.	The Notion of the United States as the Most Generous Nation	85
2.	Foreign Skepticism of American Nongovernmental Organizations	87

Chapter Five: Policy Arguments for the Promotion of “Learning-Driven” International Engagement by American Philanthropists

I.	Learning-Driven International Philanthropy Can Help Produce More Effective Results, Particularly in Addressing Problems of Systemic Poverty	91
II.	Learning-Driven International Philanthropy Can Stimulate Greater Innovation in Development Efforts Among Charities	94
III.	Learning-Driven International Philanthropy Can Allow Donors to Express a Key Motive for Charitable Giving by Enhancing Their Sense of Identification with Others	97
IV.	Learning-Driven International Philanthropy Can Project the United States’ National Interests While Reflecting Core American Values	102
V.	Learning-Driven International Philanthropy Can Help Relieve the Burdens of Overextended Federal Agencies and International Organizations	106

Chapter Six: Legal Reforms to Encourage Learning-Driven International Philanthropy by Americans	109
I. Private Foundations, International Grant Making, and the Implementation of an Officially Sanctioned Repository for Equivalency Determinations	110
1. Existing Proposals for Centralized Repositories of Equivalency Determinations	112
2. A Critical Response to Existing EDIR Proposals	113
3. Potential Paths for EDIRs Going Forward – and Avoiding Pitfalls Along the Way	115
II. Deductibility for Individual and Corporate Charitable Gifts to Certain Foreign Grantees ..	117
1. Come Together: the Importance of Markets in Global Philanthropy and the Limits of Current Marketplace Efforts	119
2. Widening the Circle of Deductibility Through the Use of Technology	121
3. Addressing Challenges Associated with Expanded International Deductibility for Individuals and Corporations	122
a. The complexity objection	122
b. The federal deficit exacerbation objection	124
c. The “charity begins at home” objection	125
4. The Legal Mechanics of Expanding Deductibility to the International Arena	126
Conclusion	129
Bibliography	133
Index	143

Acknowledgments

One of the great ironies of academic writing is that while an author's work must be presented as his or her own, none of us truly can lay sole claim to ideas, conclusions, or lines of argument. We are created to live in community, and it is through community that our minds are sharpened, our hearts are tuned, and our will is prompted to express our thoughts and convictions to the world around us. If I were to give proper credit to all those who helped bring my mind, heart, and will to the point of articulating the message of this book, I would need a second volume equal in length to this one.

For now, I will content myself to thank those whose assistance directly and specifically shaped this work. In that regard, the book certainly would not exist without the guidance, encouragement, and editing work of Professor Frank Emmert, the John S. Grimes Professor of Law at Indiana University's Robert H. McKinney School of Law. As my academic advisor in the International and Comparative Law track of McKinney's LL.M. program, Professor Emmert was the first to suggest that I should devote my thesis to analyzing the legal framework of American philanthropy. He then supported my desire to augment that analysis with legal and public policy-based critiques of American philanthropy abroad, which resulted in the latter half of this book. As my thesis supervisor, Professor Emmert not only offered invaluable editing suggestions on content, tone, and focus, but he also proposed that I develop the thesis for publication as a book. For all of this, I am most grateful.

Ben W. Blanton, Esq., served as one of two additional readers of my initial thesis draft. Ben is my law partner and the most knowledgeable attorney I know in the area of exempt organizations law. Over the years, he has freely shared his wide and deep knowledge many times, and he did so again with this work by offering technical corrections and alternative ideas – always with the same generosity and graciousness that characterizes all of his interactions.

Jeff Pedersen, Ph.D., served as the other reader of my first thesis draft. As an educator and an experienced academic writer, Jeff's input was critically important in sharpening my focus and sparing subsequent readers from some of my most egregious and annoying stylistic habits (although some undoubtedly remain despite Jeff's valiant efforts). For these contributions, and for his friendship before, during and after the writing process, I am thankful.

Numerous friends and family members regularly bless me with encouragement, honesty, and models of selfless living. In the context of this project, I must give particular thanks to four: Lowell Haines, my professional mentor and one of the earliest proponents of my mid-career pursuit of an LL.M. degree; Jeff Jacobson, who composes

a redemptive symphony each time he writes a book, an article, or an email message; Jeff Unruh, with whom every interaction leaves me feeling more alive and inspired; and Keith Carlson, who leads me and thousands of others – with his head and his heart – into lives of justice for the marginalized.

My wife, Lisa, has been my best friend and life partner for a quarter-century. Although I am far from a finished product, I am an immeasurably better man, husband, father, friend, and colleague because of Lisa's love, her encouragement, her desire to approach life as a cultural learner, and her willingness to share the learning journey with me. I now count our children – Grace, Sophia, and Josiah – as fellow travelers on that journey, and it is a joy both to teach and learn from them daily. During the writing and editing of this book, Lisa and our children gave me more patience, tolerance, and cheerleading than I had a right to expect – and for these gifts, I am even fonder of them than I was before.

All information herein is current and correct, to the best of my knowledge, as of March 2013.

S.D.G.

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*We do not necessarily need to feel guilty about our wealth.
But we do need to get up every morning with a deep sense that
something is terribly wrong with the world and yearn and strive
to do something about it. There is simply not enough yearning and striving going on.¹*

Introduction: Crossing Borders to Bridge the Gap

Much has been written about the uniquely robust level of philanthropy in the United States, both historically and in a contemporary context. Individuals and organizations in the United States indeed have established long and deep patterns of benevolent giving throughout American² history. Such giving has been measured and analyzed innumerable times and convincingly supports the conclusion that Americans generously support charitable, educational, religious, and other worthy causes.³ In 2010, for example, Americans gave nearly \$300 billion to charitable causes in the midst of the worst recession in three-quarters of a century.⁴

American Philanthropy and its Legal Framework

As Americans' patterns of giving have matured, a vast system of laws at the federal and state levels also has developed to regulate, encourage, and even protect⁵ the many actors who populate the universe of philanthropy: individual and organizational donors; charitable organizations; directors, officers, and trustees who govern charities; and numerous others. As described herein, those laws provide effective and comprehensive *regulation* of philanthropic giving in the United States, generally ensuring that

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- 1 Steve Corbett and Brian Fikkert, *When Helping Hurts: Alleviating Poverty Without Hurting the Poor . . . and Yourself* (Moody Publishers, 2009), at p. 29.
 - 2 Individuals of various nationalities throughout North, Central, and South America can lay equal claim to the term "American." In this book, however, the term occasionally is used merely as a convenience for the purpose of denoting United States nationality in a succinct manner.
 - 3 The term "charitable" periodically is used in this book to include religious, educational, and other purposes described in 26 U.S.C. sec. 501(c)(3).
 - 4 See Bruce R. Hopkins, *The Law of Tax-Exempt Organizations* (10th ed., John Wiley & Sons 2011), 2012 Supplement at p. 5 (citing *Giving USA* (Center on Philanthropy, Indiana University, 2011)).
 - 5 For example, through civil immunity statutes designed to limit the liability of individuals who serve as volunteer officers and directors of charitable organizations.

charitable gifts are used for their intended purposes, preventing the diversion of donated funds for private gain, and promoting the accountability of charitable recipients to donors and the general public.

At the same time, federal and state laws offer affirmative *encouragement* of philanthropic giving and charitable activity by offering donors the opportunity to deduct charitable gifts for purposes of the federal and state income, estate, inheritance, and gift taxes, and by providing exemptions from federal and state income tax and certain state sales taxes and local property taxes to qualifying charitable organizations. Nevertheless, such legal encouragements of philanthropy have their limits, and many of those limits may be found at the borders of the United States.

Stopping at the Water's Edge? The Need for More and Better International Philanthropy

American philanthropy does in fact stretch beyond the borders of the United States to support many charitable activities conducted in other countries. But such giving often is accomplished through gifts made to a United States charity that conducts or supports charitable activity in a foreign country if the charity determines that such programming or support furthers the United States charity's own purposes. Less frequently, American private foundations make grants directly to foreign charities, and they do so only after completing onerous processes of due diligence to avoid prohibitive penalty taxes. Rare indeed is the charitable gift by an American individual or corporation directly to a foreign charity – not surprising, in light of the fact that under current federal income tax law, such a gift usually is not eligible for deduction from the donor's gross income.

The robust level of philanthropic activity *within* the United States is both encouraged and well regulated by a mature system of federal and state laws. In this book, however, I contend that several well-placed legal reforms could encourage American individuals, corporations, and private foundations to complement their domestic philanthropic efforts with more frequent and more effective *international* philanthropic engagement.

In this context, I use the term "effective" to describe a learning-driven model of international philanthropy: an approach that places a high value on direction and control by the foreign recipient while emphasizing a posture of learning and support on the part of the United States donor. This philanthropic approach admittedly reflects a normative preference for the primacy of the foreign recipient's judgments, preferences, and objectives. Nevertheless, it comports with some of the most significant traditional motives and objectives of philanthropy. Moreover, such a learning-driven model of international philanthropy furthers key national interests of the United States.

This viewpoint on effective international philanthropy also stems from my own experiences providing legal counsel to grant makers and charitable organizations for more than fifteen years. My perspectives on this issue have been further refined by my involvement as a volunteer in transnational partnership-style charitable ventures between American and foreign charitable organizations in international settings including South Africa and a Canadian First Nations reserve. As a lawyer and a volunteer worker, I have observed firsthand the enhanced outcomes – for the recipients of charity in other countries, as well as for American donors and volunteers who benefit from these relationships – when American philanthropy and charitable engagement is conducted with an emphasis on learning from indigenous foreign leadership. The learning-driven approach offers an alternative to traditional efforts that often reflect ill-informed presumptions regarding the superiority of American judgments on the appropriate use of grants and the methodologies that will best implement grant-supported programs.

While I propose basic policy arguments in favor of the learning-driven approach to international philanthropy, a full scientific evaluation of the relative effectiveness of the approach lies outside the scope of this book, which instead features more modest objectives. First, I seek to confirm through analysis that while the current system of American laws governing philanthropic activity is appropriately well developed for the purpose of encouraging and regulating domestic philanthropy, the system is less well suited to promoting effective international philanthropy by Americans. Second, I wish to summarize the most significant policy issues affecting American philanthropy (both domestic and international) while developing arguments favoring the encouragement of learning-driven international involvement by American philanthropists. Finally, I aim to investigate and advocate tax law reforms that would encourage Americans to make learning-driven gifts directly to international charities.

Many Americans discern a vast chasm between the way things are and the way things could be throughout the world, particularly in underdeveloped countries that face systemic poverty, disease, hunger, lack of educational opportunities, and myriad other structural challenges. Through several discrete and carefully circumscribed changes to federal tax laws, more Americans – including individuals, corporations, and private foundations – could be encouraged to play a part in bridging that chasm through philanthropic giving to foreign charities. The law cannot and should not mandate global philanthropic activity by Americans, but it can encourage more frequent and more effective “yearning and striving.”

Overview of Analytical Structure

To provide context for the legal reforms suggested above, I first offer a survey of the existing framework of United States laws that affects philanthropic activity on both the domestic and international fronts. Chapter One thus begins by summarizing the scope of philanthropic activity in the United States and the breadth of the sector in which

charitable grants are made. The opening chapter then offers a review of the various forms of legal entities utilized by philanthropists, as well as the state-specific procedures addressing the formation of organizations with charitable objectives. This background should provide a useful framework for exploring the connections between state-level legal forms and the classifications used in federal tax law to distinguish among various tax-exempt organizations.

Chapter Two explores the positive and negative impacts of various federal and state laws on general philanthropic activity. Following an initial overview of the policy rationales justifying federal income tax exemption, this chapter addresses the most significant legal regimes affecting philanthropy, including federal laws providing and regulating income tax exemption for charitable organizations; laws of general applicability governing the operation of charities, including federal-level reporting requirements, public disclosure rules applicable to charities, state-level regulation of charitable solicitations, and exemptions from state and local taxes; the important distinctions between private foundations and public charities, including the excise taxes and other unique rules imposed on private foundations; and the rules governing the tax deductibility of charitable gifts made by individuals and corporations, including an overview of the current legislative state of affairs as it relates to proposed deductibility limits to reduce the federal government's burgeoning debt.

Chapter Three turns to an examination of legal frameworks specifically impacting international philanthropy. In this chapter, I first analyze the general prohibition on the deductibility of gifts to foreign charities from individual and corporate income. The analysis then focuses on the detailed rules governing private foundation grants to foreign organizations, accompanied by a brief discussion of recent developments in the laws governing program-related investments by private foundations in the international context. Finally, Chapter Three compares the foregoing legal regimes to the equally detailed rules applicable to gifts made by individuals, corporations, and private foundations to intermediary United States charities that use such gifts to conduct or support foreign charitable activities.

Chapter Four shifts the discussion from analysis of legal frameworks to an investigation of the non-legal policy and practical issues that inevitably affect, and to some extent circumscribe, any discussion of charitable giving. In this chapter, I initially address general policy issues affecting all philanthropy, whether domestic or international, including an overview of relevant economic, sociological, and philosophical commentaries on philanthropic motivations. This general policy analysis also includes a discussion of the effects on private philanthropy of political and ideological views regarding the appropriate roles and limits of governmental responsibility for social services, the reality of persistent federal budget deficits, and the erosion of the tax base. Moving to a more specifically international context, Chapter Four next contextualizes the United States' role as a traditionally generous nation by studying the

extent of international giving by Americans, acknowledging debates on the roles of government-sponsored foreign aid, and exploring the varied perceptions of American charities in other countries.

Chapter Five commences with a description of the learning-driven approach to international charitable giving, which accounts for the policy factors described above while promoting a mode of global philanthropic engagement that emphasizes a presumptive preference for local foreign leaders, rather than American grant makers, as the appropriate framers and solvers of problems. The balance of Chapter Five reviews literature across diverse disciplines as a backdrop for arguments favoring the utility of the learning-driven model, including (among others) its use as an effective problem-solving approach to persistent problems of poverty in under-developed countries, an incentive to innovation and risk-taking on the part of individual and institutional philanthropists, an encouragement of closer identification with grantees on the part of grant makers, and a means of protecting and projecting the national interests of the United States.

In Chapter Six, the discussion returns to legal analysis with a discussion of specific proposals for tax law reform that would promote the policies undergirding the learning-driven approach to international philanthropy. Chapter Six includes a critique of the recent proposal to create a repository for equivalency determinations that could ease the burdens associated with private foundations' grants to foreign charities.⁶ The chapter and the book conclude with a proposal to offer limited federal income tax deductibility for charitable gifts made directly to certain foreign charities by American individuals and corporations. The discussion of this proposal includes a technical description of the requisite changes to federal law, a consideration of relevant practical difficulties and policy objections, and an examination of the methodological and technological tools (including the use of electronic equivalency determination repositories) that could be developed to implement such legal changes in an effective and responsible manner.

6 See, e.g., Diane Freda, *Private Foundations Ask IRS to Allow Repository for Foreign Grant Information*, BLOOMBERG BNA DAILY TAX REPORT, May 2, 2012.

Index

"Action" organizations 28
 Administrative expenses as qualifying distributions 46
 Advisory Committee on Tax Exempt and Government Entities (IRS)..... 33, 112-15
 Amendments to federal statute proposed by author 127
 "American Friends of" organizations 78-79
 Annual return,
 - Form 990 33-35
 - Form 990-PF 52
 Application for obtaining tax exemption (Form 1023) 31-33
 Anti-Terrorist Financing Guidelines, Department of Treasury 73-74
 Approval process for private EDIR operators, proposal for 116-17, 121, 123

 Bellah, Robert 82, 99
 Bono 91, 93-94
 Boulding, Kenneth 83, 97-99, 101-02
 Buddhism and philanthropy 98-99

 Charitable gift, definition 54
 China, international development activity by 80-81
 Christianity and philanthropy 98
 Churches as public charities 39
 Clinton, Hillary 90
 Clooney, George 91
 Collier, Paul 94-95
 Commensurate test 25-26
 Community foundations 40
 Control by domestic charity in supporting foreign activities 77, 80
 Corbett, Steven 11, 90, 99, 131
 Corporate form for exempt organizations 19-20
 Corporate gifts to domestic charities for international programs 65
 Corporate gifts to foreign charities 65
 Currently qualified affidavits and equivalency determinations 69-70, 111

 De Tocqueville 83-84
 Deductibility limitation proposals 58-61
 Deductibility of charitable gifts, in general 53-61
 Deductibility of charitable gifts to foreign grantees, proposal for 117-28
 Deducibility of gifts to intermediary charities to support international activities 77-79
 Deficits (federal government) and charitable deduction challenges 58-61, 124
 Dividends, tax treatment of 30
 Disqualified persons and self-dealing 49
 Domestic charities, charitable gifts to for international use 76-79
 Donor–advised funds 44
 Donative public support tests 40-41

Easterly, William.....	92-94, 105, 120
Effectiveness and international philanthropy.....	91-94
Egypt and American NGOs.....	87-88
Election activity.....	27-28
Emmert, Frank.....	92-93
Equivalency determination information repositories ("EDIRs").....	110-17, 130-31
English language requirement for currently qualified affidavits.....	69
Entity choice for charitable organizations.....	18
Equivalency determinations.....	67-70, 111
Excess business holdings by private foundations.....	50-51
Exempt organization types.....	17
Expenditure responsibility,	
- in general.....	48
- international grant making.....	71-72, 111
Extent of charitable giving by Americans.....	11, 16, 85-86
Fikkert, Brian.....	11, 90, 99, 131
Foreign aid by governments, critiques of.....	86-87
Foreign charities, non-deductibility of gifts to.....	55, 63-66, 129
Formation of nonprofit corporations.....	19-20
Fundraising registration requirements.....	35-36
Global Fund to Fight AIDS, Tuberculosis, and Malaria.....	108
Globalization and deductibility for foreign charitable gifts.....	80, 117-19
GlobalGiving.....	120-21
Good faith determinations and equivalency determinations.....	68-69, 111
Grant agreements with foreign grantees.....	71
Grants economy (Boulding).....	83
Grants Managers Network.....	113-14
Grants to non-public charities as taxable expenditures.....	48, 110, 115
Grants to public charities as qualifying distributions.....	46
Gross receipts public support test.....	41-42
GuideStar USA.....	35
Hopkins, Bruce.....	11, 16-17, 21, 23, 25, 29, 32, 39, 43-45, 56, 64-67, 78, 106, 111
Hospitals as public charities.....	40
Identification with others as motive for international philanthropy.....	97-102
Innovation and international philanthropy.....	94-97
Intermediary charities, charitable gifts to for international use.....	76-79, 120-21, 129-30
International grants by private foundations.....	66-76
Islam and philanthropy.....	98
Jeopardy investments by private foundations.....	51-52
Jolie, Angelina.....	91
Kerry, John.....	102

Learning-driven philanthropy, in general.....	12, 90, 130
Legislative activity.....	26-27
Limitations on proposals for deductibility of foreign charitable gifts.....	124-26
Limited liability companies.....	18
Lobbying limitation, in general.....	26-27
Lobbying prohibition for private foundations.....	47
Local tax exemption.....	37
Low-profit limited liability company ("L3C").....	18, 109-110
Marketplace, philanthropy as.....	105-06, 119-21
Marshall Plan.....	85
Millennium Development Goals.....	91
Minimum payout requirement.....	45-46
National interests and values, international philanthropy and.....	102-06
Net investment income tax.....	45
Nielsen, Waldemar.....	26, 45, 47, 95-96, 104, 106-07, 119
Non cash charitable gifts.....	56
Non-charitable purpose payments as taxable expenditures.....	47-48, 110, 115
"Nonprofit" v. "tax-exempt" definitions.....	16-17
Nye, Joseph.....	103
Objections to expanded deductibility for foreign charitable giving.....	122-26
Office of Foreign Assets Control ("OFAC"), Department of Treasury.....	73
Operational requirement.....	25-26
Organization for Economic Cooperation and Development ("OECD") data on giving.....	86
Organizational requirement.....	24-25
Outsourcing to nongovernmental operators (proposal in EDIR context).....	116-17
Percentage of income limits on charitable deductions.....	58-61
Perceptions abroad of American philanthropists.....	94, 104
Personal motivations for charitable giving.....	82-84
Planners (Easterly).....	92, 94, 105, 120
Political campaign activity prohibition.....	27-28, 47
Political ideology and philanthropy.....	84-85
Pre-grant inquiry for foreign grantees.....	71
Private foundations.....	38, 44-53
Private inurement.....	24
Private letter rulings.....	113, 116
Program-related investments ("PRIs") and international grant making.....	74-76
Property, charitable gifts of.....	56-57
Property tax exemption.....	37
Proposed regulations of Department of Treasury on good faith determinations.....	68-69, 127
Proposed regulations of Department of Treasury on PRIs (April 2012).....	75-76
Public charities.....	38-44
Public inspection requirements.....	35, 52
Public support tests.....	40-42

Putnam, Robert.....	98, 104, 125
Qualifying distributions.....	45-46, 110, 115
Rationales for tax exemption.....	22-23
Reasonable judgments and equivalency determinations.....	68, 111
Relief of government agencies and international organizations, philanthropy and.....	106-08
Rental income, tax treatment of.....	30
Reform of federal tax laws affecting international philanthropy.....	109-28, 130-31
Reporting requirements for foreign grantees.....	71-72
Requirements for tax exemption under Code section 501(c)(3).....	23-28
Religious motivations for philanthropy.....	98
Retroactive effect of exempt status.....	32
Revenue Act of 1938.....	64
Revenue procedures.....	114-15
Revised Model Nonprofit Corporation Act.....	19
Risk Matrix for the Charitable Sector, Department of Treasury.....	74
Royalties, tax treatment of.....	30
Russia and American NGOs.....	88, 104-05
Sales tax exemption.....	36-37
Sachs, Jeffrey.....	91-93, 96, 107
Scholarship grants and taxable expenditures.....	47, 116
Schools as public charities.....	39
Searchers (Easterly).....	92, 94, 105
Self-dealing.....	49-50
Sen, Amartya.....	99-101
Services, non-deductibility of.....	54-55
Social capital.....	98
Soft power, philanthropy and.....	103-04
Solicitation registration requirements.....	35-36
Specially designated nationals.....	73
State tax exemption.....	36-37
Substantiation requirements for charitable gifts.....	55-57
Supporting organizations.....	42-44
Taxable expenditures.....	46-49
"Tax-exempt" v. "nonprofit" definitions.....	16-17
Tax on net investment income.....	45
Tax Reform Act of 1969.....	45, 106
Tax treaties of United States with Canada, Israel and Mexico.....	63-64, 126
Tech Soup Global.....	113-15
Technology as tool for effective international philanthropy.....	121-24
Terrorism and international grant making.....	73-74
Tippling by private foundations (public support tests).....	42
Transactions between private foundations and disqualified persons.....	49-50
Trusts.....	18-19

Type III supporting organizations and taxable expenditures	48-49
U2	100
UBIT	29-31
Unified registration statement	35
Unincorporated associations	19
United Kingdom, deductibility limitation proposals in	61
Unrelated business income tax	29-31