American Friends OF
Canadian Conservation

U.S. Recognition as a Publicly-Supported Charity

A fact sheet for Canadian charities involved in Cross-border Conservation

Introduction

This Fact Sheet is one of a series created by American Friends of Canadian Conservation (AFCC) to support Canadian conservation organizations working in geographies where U.S. taxpayers own priority properties. AFCC is a U.S. 501(c)(3) charity that was created to partner with Canadian organizations to protect ecologically significant properties owned by U.S. taxpayers and to increase funding for conservation in Canada. The Fact Sheet explains why Canadian charities should consider applying to the U.S. Internal Revenue Service (IRS) for recognition as a Publicly-Supported Charity; what the application entails; and how to maintain that recognition after it is received.

The principal benefits of such recognition are:

(1) a U.S. based charity, such as AFCC could transfer a conservation easement or remainder interest donated to it by a U.S. taxpayer under Section 170(h) of the Internal Revenue Code (IRC) to the Canadian charity; and

(2) a U.S. taxpayer who makes a donation to the Canadian charity could take an increased tax deduction on their U.S. tax return of up to 50% of the donor's **Canadian source income** rather than up to 30% limit for donations to a Canadian charity that is not recognized by the IRS.

Other benefits are described below.

IRS recognition of the Canadian charity as a Publicly-Supported Charity, however, does **not** entitle a U.S. donor to apply a donation against U.S. source income. That can be done only if the contribution is made to a U.S.-based charity, such as AFCC. A partnership with AFCC allows Canadian entities to tap the substantial bi-national financial incentives available, which can make gifts of land, partial interests, cash or securities tax deductible against U.S. income, or estate taxes, on a U.S. donor's tax return.

Canadian charities interested in partnering with AFCC and eventually receiving transfers of conservation easements or remainder interests **must** be recognized by the IRS as a Publicly-Supported Charity before any transfer from AFCC to the Canadian charity occurs. This is a requirement for the gift to be (and to remain)

deductible against U.S. income or the value of a decedent's estate. It is not a requirement when AFCC transfers fee title to a Canadian charity.

What is "Status as a Publicly-Supported Charity" and Why is it Necessary?

Under U.S. tax law, gifts of partial interests in land must meet the standards of a "qualified conservation contribution."[1] One of the requirements of a qualified conservation contribution is for the entity receiving the gift to be a 'qualified donee'[2] which includes being deemed by the IRS to be a 'publicly-supported charity,' as opposed to a private foundation.

A 'publicly-supported charity' is a charity that generally receives a substantial part of its support in the form of contributions from other publicly-supported organizations, governmental units, and/or the general public. Private foundations, on the other hand, are generally funded by a small group of individuals, a family or even one person.

Under the terms of the Canada-US Income Tax Treaty, Canadian charities automatically are assumed to be "private foundations"[3] under U.S. tax-exempt law. Canadian charities can, however, secure recognition from the IRS as a Publicly- Supported Charity if they can demonstrate that they meet the requirements of a Publicly-Supported Charity. And if a Canadian charity secures and maintains such recognition, it will be a "qualified donee" eligible to accept conservation easements (and other qualified conservation contribution of land such as a remainder interest).

Securing U.S. "Publicly-Supported Charity" Status

To receive IRS recognition as a Publicly-Supported Charity, a Canadian Charity must apply to the IRS for such recognition.

The application process involves two steps for the Canadian charity:

(1) Obtain an Employer Identification Number (EIN) by completing IRS Forms SS-4;[4] and

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[1] **Qualified Conservation Contribution-** has the meaning assigned by section 170(h)(1) of the Internal Revenue Code, further qualified by § 1.170A-14 (a) of the Treasury Regulations to Internal Revenue Code section 170 (h); defined as a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes.

[2] **Qualified Donee** (IRS) - has the meaning assigned by section 170(h)(3) of the Internal Revenue Code, further qualified by § 1.170A-14(c)(1) of the Treasury Regulations to Internal Revenue Code section 170 (h). The definition includes: a governmental unit described in section 170(b)(1)(A)(v) of the Internal Revenue Code (which provision only applies to U.S. governmental units); an organization described in section 170(b)(1)(A)(vi) of the Internal Revenue Code; a charitable organization described in section 501(c)(3) of the Internal Revenue Code that meets the public support test of section 509(a)(2); OR a charitable organization described in section 501(c)(3) of the Internal Revenue Code that meets the requirements of section 509(a)(3) and is controlled by an organization described in paragraphs (c)(1) (i), (ii), or (iii) of § 1.170A-14 of the Treasury regulations to Internal Revenue Code section 170 (h).

[3] **Private Foundation** -- In general terms, a private foundation is an organization described in the Internal Revenue Code 501(c)(3) which does not meet the public support test of Internal Revenue Code 509(a)(1) or 509(a)(2)

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[4] **Employer Identification Number (US)** – To apply, the charity must submit *Form SS-4: Application for Employer Identification Number*. The Internal Revenue Service publication *Instructions for Form SS-4* is helpful in completing the application.

(2) Submit the following documents to the Internal Revenue Service (but first check the IRS website to find if there are additional or updated instructions):

- Copy of its Notification of Registration from the Canada Revenue Agency (CRA);
- Part I of IRS Form 1023; [5]
- Part X of Form1023 to request Public Charity classification and to demonstrate that the Canadian charity meets the public support test for a 5-year period (if it has been existence that long);
- Signature line of Part XI of Form 1023; and
- IRS Form 8833, Treaty-Based Return Position Disclosure under Section 6114 or 7701(b) (and IRS Notice 99-47) concerning Article XXI of the United States-Canada Income Tax Convention.

In addition, the Canadian charity will also usually submit an IRS Form 2848 Power of Attorney to allow its counsel to represent it with respect to interactions with the IRS on the application.

The most important part of the application is the demonstration that "qualifying support is at least one-third of 'total support' over the applicable period." This is referred to as the "public support test." The formula for calculating the percentage of public support is based on a consideration of the following elements:

- The accounting year for the Canadian charity
- The sources of support over the applicable period (last 5 accounting years or all the accounting years the Canadian charity has been in existence)
- The sources of support that count toward "total support" (the denominator of the public support fraction) and the sources of support that only count toward "qualifying support" (the numerator of the public support fraction) over the applicable period.
  - Contributions from governmental entities (including government donation of services/facilities) and other publicly-supported charities count w/o limitation as total support (denominator) and qualifying support (numerator).
  - Donations from any private sources (corporation, trust, individual, private foundation, etc.) count as qualifying support only to the extent of 2% of total support received over the period. In addition, gifts from persons or entities (family member, business entity) related to a "substantial contributor" (a person or entity who has contributed at least $5,000.00 to the organization, or 2% or more of its total support, whichever is larger) are aggregated and counted together, as if they were all made by one individual, for the purpose of determining if a particular contribution counts as qualifying support.
  - Unrelated income and investment income ("interest and dividends") only count as total support.

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[5] **Application for Tax Exempt Classification (US)** -- To receive a determination that a charityis not a private foundation, and that it meets the requirements of the public support test for accepting conservation easements, the charitymust complete *Form 1023*.

- Capital gains, exempt function income (including fees from government agencies for services provided), so-called "unusual grants",[6] and private donations of services are not included in either qualifying support or total support.

Given the complicated nature of this public support calculation, a Canadian charity applying for recognition as a Publicly-Supported Charity would be wise to engage advisors (lawyer and/ or accountant) who are familiar with the IRS public support test requirements, to help them through the accounting steps associated with preparing and submitting an application to the IRS.

The IRS processing time varies greatly. If the application is missing required information or if the public-support test calculations were done incorrectly, the IRS will ask for additional information and documentation. If the Canadian charity meets the required criteria, it will receive a "determination letter" from the IRS specifying the charity's tax-exempt status and public support classification.

Maintaining U.S. "Publicly-Supported Charity" Status

Once a Canadian charity receives its "determination letter" from the IRS recognizing it as a Publicly-Supported Charity, the Canadian charity's most important obligation thereafter is one of filing a IRS Form 990 (or IRS Form 990-EZ) annually with the IRS, BUT ONLY if its gross receipts from sources within the United States are more than $50,000USD or if the organization has significant ongoing activity in the United States. If the organization does not have more than $50,000USD in annual gross receipts from sources within the United States, it must submit annually the IRS Form 990-N e-Postcard annually instead of IRS Form 990 or IRS Form 990-EZ.

Failure to file or submit the required annual return or notice for three consecutive years results in automatic revocation of recognition by the IRS as a Publicly-Supported Charity. The return must be filed by the 15th day of the 5th month after the end of the organization's accounting period.

Additional Benefits of U.S. Publicly-supported Charity Status

As described in the Introduction, Canadian charities planning to accept donations of partial interests of properties (e.g., conservation easements or remainder interests) from U.S. taxpayers, including AFCC, must obtain IRS recognition as a Publicly- Supported Charity. But there are other reasons organization may wish to be so recognized by the IRS as described below.

[6] Unusual grants" are substantial gifts that are unexpected either in size or timing. Often they are from an individual or entity not previously known to the organization. See Rev. Proc. 81-7, 1981-1, C.B. 621 the factors to consider in determining if a grant is "unusual" for public-support test purposes.

Enhanced Income Tax Benefits on Canadian-Source Income

When a U.S. taxpayer makes a gift directly to a Canadian charity, whether cash or real estate, they cannot claim a U.S. tax deduction against U.S. income. However, the Tax Treaty between Canada and the U.S. provides for deduction of cross-border charitable contributions and reciprocal recognition of charitable status for Canadian and U.S. charities.[7] U.S. residents may claim income tax deductions against Canadian-source income. There are special rules relating to such gifts.

As mentioned earlier, by default the IRS classifies Canadian charities as private foundations. U.S. taxpayers may claim charitable deductions for gifts to such private foundations but they are subject to limits of 30% of adjusted gross Canadian-source income or 20% for gifts of capital property.[8] Donors can carry forward excess contributions and deduct them in the five subsequent taxation years, subject to the same limitation.

Organizations classified in the U.S. as private foundations are not qualified to accept gifts of partial interests such as conservation easements and remainder interests for conservation purposes from U.S. taxpayers. Doing so risks serious tax consequences to the donor.

The deduction limits for donations made to an organization with Publicly-Supported Charity status are more generous. The ceiling is raised from 30% to 50% of adjusted gross Canadian-source income for gifts of cash. The deduction limit for gifts of capital property increase from 20% to 30% of adjusted gross income Canadian-source income. The limit increases to 50% for capital property for which the claimed deduction is limited to the donor's adjusted basis[9].

Charities with this status can also accept gifts of qualified conservation contributions in land (see discussion below).

Increased Funding Support

Donors from the U.S. may feel more confident making gifts to an organization that is recognized as a Publicly –Supported Charity. It will be listed in IRS Publication 78, Cumulative List of Exempt Organizations, as a foreign organization. The classification may also help Canadian charities to secure funding support from U.S. foundations.

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[7] **Tax Treaty (charity status)** – The Canada-United States Income Tax Convention (1980), paragraphs 5 and 6 of Article XXI. The Treaty and *Notice 99-47* state that all Canadian charities are recognized under Section 501(c)(3) but are assumed to be a private foundation unless they receive an Internal Revenue Service determination otherwise (i.e. recognition as a *publicly-supported charity*).

[8] **Contributions Under Tax Treaty** – Bes ides being subject to the overall limits applicable to all charitable contributions under U.S. tax law, charitable donations to Canadian organizations are subject to the U.S. percentage limits on charitable contributions, applied to the donor's Canadian-source income.

[9] **Step-Down Election (US)**—Under the Internal Revenue Code Section 170(b)(1)(C)(iii)), a U.S. donor m ay us e a "step-down" election to reduce the amount of the contribution of a capital property to the taxpayer's bas is in the property, in order to increase the percentage limitation (percentage of the donor's adjusted gross income for the year of the gift for which the donor can make deductions) from 30% to 50%. The basis is the acquisition cost plus capital improvement costs, or for inherited land, the value upon inheritance.

Cross-Border Gifts of Conservation Land, Easements and Conservation Remainders

Outright Gifts of Land to a Canadian Conservation Organization

Gifts of land from U.S. donor to a Canadian registered charity with Publicly-Supported Charity status will create additional U.S. income tax benefits against **Canadian-source income**.

Bequests of Land to Canadian Conservation Organization

Testamentary gifts of land result in the same U.S. estate tax deductions, regardless of whether the donee is Canadian or American, provided that the Canadian charity is recognized by the IRS as a Publicly-Supported Charity.

Donations or Bequests of Partial Interest in Land to a Canadian Organization

As discussed above, under U.S. tax law a gift of a partial interest in real property must meet the standards for a "qualified conservation contribution," and the donee must be a U.S.-based entity for it to be an eligible deduction against U.S. source income. (See discussion of special requirements for such gifts in the Fact Sheet for Donors available at www.conservecanada.org) Even if the donor is willing to forego the U.S. income tax deduction and wants to grant the easement or other gift of partial interest in land directly to a Canadian entity there is another potentially significant issue.

If a Canadian charity that is not recognized by the IRS as a Publicly-Supported Charity, accepts a conservation easement or other partial interest from a U.S. taxpayer, the donors' heirs may face an estate tax liability because the recipient is not a "qualified donee" for such a gift. Although the current U.S. estate tax exemption is so high that few U.S. taxpayers' estates pay the tax, it is important that Canadian conservation organizations understand and communicate the potential implications.

The reduction in land value resulting from the restrictions established in the conservation easement, or other gift of partial interest, may not be considered in determining the value of the donor's estate. Estate tax can be imposed on the value of the decedent's property as if there were no restrictions in place. This could be a serious financial strain in situations where property values are high, and the conservation restrictions would substantially diminish the market value.

An unexpectedly high value for estate tax purposes due to conservation restrictions not being considered could potentially force the donor's heirs to sell a cherished conservation property to pay the estate taxes. The restrictions would still be legal under Canadian real estate laws (even though not recognized under the U.S. estate tax laws) so the fair market value of the property could be significantly lower than the estate tax value. And the donee would still be obligated to enforce the restrictions.

Conclusion

Although all Canadian charities are recognized as equivalent to U.S. charities by the IRS, they are classified as 'private foundations.' Securing recognition as a Publicly-Supported Charity can allow a Canadian organization to tap U.S. tax benefits from donors who have Canadian income that they declare on their U.S. tax return, making it easier to secure gifts of cash, land or conservation easements from U.S. taxpayers.

If a U.S. income tax deduction (against U.S. source income) is the incentive needed to make the gift financially feasible, the donation must be made to a charity based in the U.S., such as AFCC. Any subsequent transfers of partial interests from the U.S. charity/donee to a Canadian charity must be made to a Publicly-Supported Charity recognized as such by the IRS.

For more information

Contact American Friends of Canadian Conservation (www.conservecanada.org) to learn about cross-border conservation. Visit the Resources section of the website to find publications and additional fact sheets.

Contact Us

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