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Giving across the Atlantic: cracking the US-UK charitable giving codes

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The increased globalisation of many families is resulting in a rise in cross-border charitable giving. This can be great for charities who now have potential donors across the world, and UK charities may turn their sights to notoriously generous countries like the US for donations. But cross-border giving presents challenges as well and the US is no exception. With its unique tax system and often confusing rules, it can present a potential minefield for unwary fundraisers or legacy officers. The aim here is to demystify a few of the rules, particularly with regard to legacies by US people, legacies of US assets by non-US people, and the drafting requirements for qualified legacies.

The US is unique in taxing citizens regardless of their residence. The US assesses US citizens' and US residents' income tax on worldwide income, and transfer tax (eg estate and gift tax) is assessed on US citizens' and US domiciliaries' worldwide assets. US income tax rates reach 37% at the moment on annual incomes over around $500,000 (for single filers) while US estate tax is 40% on the value of assets over $11.58 million ($10 million indexed for inflation annually). The extraordinarily high US estate tax exemption came in at the beginning of 2018 and is set to sunset at the end of 2025, when it will decrease to the prior exemption of $5 million indexed.

When it comes to lifetime charitable giving, US people seeking tax relief must make gifts to charities formed and recognised in the US. This territoriality requirement will not be new for UK charity fundraisers because the UK imposes a similar requirement for UK residents (or donations of UK income). For US people also resident in the UK, the dual territoriality requirement presents a significant hurdle for tax relief. Fortunately, there is a solution in the form of a dual qualified charitable structure, which involves two charities: one formed in and registered in the UK and the other formed in and registered in the US. The two are then 'linked' through a US tax election to treat the UK charity as a disregarded entity in relation to the US charity. The effect is that gifts made to the UK charity simultaneously qualify for UK and US tax reliefs.

However, legacy gifting by US people is more flexible. US people can leave assets on death to any charity in the world so long as the charity looks like a US charity in its objects and operations and still qualifies for the US estate tax charitable deduction. This is markedly different to the UK rules, which require legacies left to UK charities to qualify for inheritance tax relief. This flexibility opens many more opportunities for US donors and non-US charities alike. Some UK legacy officers likely will point out that when they receive legacies from US donors they are often asked to produce an IRS determination letter stating they are a 501©(3). This is a convenient shortcut for executors trying to determine whether a legacy qualifies for US estate tax relief but is not strictly necessary, and an opinion from a qualified lawyer (ahem!) should satisfy those executors. Further, the request for an IRS determination letter should not be confused with a request for either an IRS withholding form or IRS tax identification number, both of which should be straightforward and will not unnecessarily subject the UK charity to ongoing US obligations.

Despite the flexibility in legacy gifts by US people, the situation is very different for legacy gifts of US assets by non-US people. In order to qualify for US estate tax relief, such legacies must be made to charities formed in and recognised in the US (similar to the rule for lifetime gifting by US people). What's more, non-US people do not get the benefit of the generous US estate tax exemption, but rather only benefit from $60,000 – not enough to cover that condo in Florida. So what can the UK domiciliary with US assets do? The first port of call is the US/UK estate and gift tax treaty to see whether (i) the assets are excluded from US estate tax under the terms of the treaty or (ii) the UK domiciliary can report worldwide assets to the IRS in order to get the full US exemption amount as provided in the treaty. If the treaty does not work, the only solution is for the legacy to be made to a dual qualified charity, as discussed earlier. With a dual qualified charity, a UK domiciliary can leave a legacy of US assets that simultaneously qualifies for the US estate tax deduction and UK inheritance tax relief.

And what about the language of the legacy itself? It is so easy to get caught up in the qualification of the recipient charity and overlook the drafting of the will. But in the US this is crucial and can mean the difference between a qualifying legacy and one that is subject to 40% US estate tax. The US wants to reward generous testators and not just generous executors and the US estate tax deduction is only available when the testator demonstrates donative intent and the legacy is for a determinate amount at the date of the donor's death. Typically, this would be stated in the will as an absolute amount (e.g. $10,000), a portion (eg one-fifth) of the estate or the residue after all other distributions have been made (e.g. the residuary estate). If, instead, the will allows the executor or trustee to make gifts among charitable and non-charitable beneficiaries, there is no

determinate amount guaranteed for charitable beneficiaries and therefore no US estate tax deduction. The US also does not recognise Deeds of Variation so it is important to get the drafting right from the start.

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