



Philanthropic organizations and business activity: what are the tax issues?

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WELCOME

Prof. Henry Peter, Head of the Geneva Centre for Philanthropy (GCP)

PANEL

Prof. René Bekkers, Director of the Center for Philanthropic Studies at the Vrije Universiteit (VU) Amsterdam, Member of the Scientific Committee of the Geneva Centre for Philanthropy

Prof. Xavier Oberson, Professor of Swiss and International Tax Law, University of Geneva

Dr. Raphaël Gani, Judge, Swiss Federal Administrative Court

Q&A

Moderated by **Dr. Giedre Lideikyte Huber**, Senior Research Associate, Geneva Centre for Philanthropy

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Prof. Henry Peter, Head of the Geneva Centre for Philanthropy

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Mrs. Laetitia Gill, Executive Director of the Geneva Centre for Philanthropy

WELCOME - Prof. Henry Peter

Prof. Henry Peter introduces the 2019-2020 academic year's first Philanthropic Lunch, welcoming the panel and the record number of participants. He highlights that the GCP's mission is to look at philanthropy from different angles, including law, economy, sociology, psychology, ethics, philosophy, and neurosciences among others.

One of the important research areas of the GCP is taxation and philanthropy and how they interact with each other¹. The research - which is supported by the Swiss National Science Foundation and led by Dr. Giedre Lideikyte Huber, Senior Research Associate at the GCP – aims to answer the following questions using multidisciplinary approach:

1. Are tax incentives for philanthropy justified?
2. Which types of tax incentives for philanthropic activities are conceivable and what is their respective efficiency?
3. Should tax barriers for cross-border philanthropy be eliminated?
4. Should social entrepreneurs enjoy tax reliefs as do foundations? How should the legal boundaries of the philanthropic sector evolve in the near future?

This Philanthropy Lunch was organized to provide a preview of possible answers to some of these questions and discuss different approaches to this topic.

¹ The research is entitled "*Philanthropy and taxation: legal and economic analysis of the efficiency of the existing legal framework and legislative proposals*". It will inter alia lead to an international conference which will take place in Geneva on 26 and November 2020.



PANEL

Dr. Giedre Lideikyte Huber explains the reasons behind the choice of the topic. The focus is on the tax consequences that arise when a non-profit entity undertakes commercial activities because a number of questions arise in this domain, such as to what extent, without losing their tax-exempt status, public-purpose entities can engage into commercial activities and whether governments should give more freedom for developing commercial activities of public benefit organizations in order to create a more vital nonprofit sector. She then introduces the speakers.

First, **Prof. René Bekkers** is Director of the Center for Philanthropic Studies at the Vrije Universiteit (VU) Amsterdam and serves as a member of the Scientific Committee of the GCP. He is the Research Chair of the European Research Network on Philanthropy (ERNOP). One of his current research projects focuses on the new charity law reform that provides tax advantages to cultural entities.

Second, **Prof. Xavier Oberson** is Professor of Swiss and International Tax Law at the University of Geneva. He is an outstanding scholar and has in-depth expertise in working with nonprofit organizations. His current research concentrates on taxing artificial intelligence, but he also works a lot with non-profit organizations, especially in the cultural field.

Finally, **Dr. Raphaël Gani** is a Judge at the Swiss Federal Administrative Court and a well-known researcher. He serves as the Editor-in-Chief of the Swiss Tax Law Review. He also lectures in Federal Tax Expert Diploma courses.

Prof. René Bekkers: Culture change takes time

Prof. Bekkers presents his research project about the evaluation of changes in charitable giving and philanthropy in the Netherlands as a result of the charity law reform. The Center for Philanthropic Studies in Amsterdam focuses on how corporate, foundation, and household giving change overtime when circumstances in society change or when a donor's own position changes. In 2012, the Dutch charity law was amended to support arts and culture organizations to increase donations and their income raised from

commercial activities and to decrease their dependence on government funding. As the charity law reform has served as a real-life experiment on taxation and philanthropy, Prof. Bekkers and his team have conducted several research projects in this field. In his presentation, Prof. Bekkers addresses the question of what other countries can learn from the Dutch experiment.

Due to the 2012 charity law reform, arts and culture organizations receives a differential advantage over to other sectors of philanthropy to support their fundraising activities and income diversification and to decrease their dependence on government subsidies. The reform package contains 4 important elements that have affected the Dutch cultural sector:

- The Government cuts its budget for arts and culture by 20 percent,
- The Ministry of Culture provides fundraising and cultural leadership workshops for cultural nonprofit organizations,



- The new charity law provides more possibilities for cultural nonprofit organizations to earn commercial income, and
- The new charity law also enhances the deductibility of donations to cultural nonprofit organizations

It is difficult to determine whether the increased tax-deduction rate itself made any difference in giving. Prof. Bekkers shares some important findings based on his research project. On the giving side, corporate giving to the arts increased significantly in 2015 (3 years after the legal change), however corporations do not usually use the enhanced deductibility offered by the new law. On the recipient side, in 2015, more entrepreneurial nonprofit organizations had an increase on fees and donations and were less reliant on government subsidies, opposite to the less entrepreneurial nonprofit organizations. Prof. Bekkers then discusses the Matthew effect. According to that effect, more successful - and entrepreneurial - nonprofit organizations become even more successful. In the Netherlands, bigger cultural nonprofit organizations were usually less affected by the government cuts and had more experience on fundraising and capacity building after the charity law reform. Many of the big cultural nonprofit organizations became more successful after the regulatory changes, while 20 percent of cultural nonprofit organizations registered by the Tax Authority disappeared by 2015.

Prof. Bekkers concludes his presentation by sharing 4 takeaways from the Dutch experiment:

- 1) tax deductibility does not increase giving automatically, cultural changes take time and investment;
- 2) nonprofit organizations need to be prepared and supported to adapt to changes;
- 3) it is important to identify challenges and limitations prior to any legal changes;
- 4) stakeholders need to share experience and learn from different legal changes.

Prof. Xavier Oberson

Prof. Oberson starts his presentation with 3 different tax trends that have an impact on Swiss philanthropy in relation to business activities performed by non-profit organizations. First of all, the legal landscape for philanthropy in Switzerland has clearly improved in the last 10 years. As an example, since 2018, companies having a non-profit purpose are also exempt from federal taxes. However, the distinction between ideal-purpose organizations and public-utility organizations is not quite clear. Second, tax administration is getting stricter with regard to the conditions that nonprofit organizations need to fulfill in order to benefit from a tax-exempt status. As an example, in case they conduct activities abroad, nonprofit organizations need to prove that their foreign activities meet all kinds of requirements. The third trend in philanthropy is the call for tax responsibility, as many multinational entities became suspicious due to their very low overall tax rates.

Prof. Oberson then highlights the 4 conditions for enjoying tax-exempt status in Switzerland:

- Public-utility purpose,
- Disinterest,
- Activities effectively consistent with the bylaws,
- Irrevocability



Prof. Oberson then discusses whether it is possible for nonprofit organizations to pursue business activities in the light of the 4 conditions mentioned above. He uses the example of the Montreux Jazz Festival that has both business (ticket sale, merchandise) and philanthropic (workshops, music competition) activities. A partial exemption of one single foundation performing both types of activities is conceivable, but difficult to implement from a practical stand point since costs and revenues are often not easy to allocate. The solution was to create 2 parallel foundations, one that organizes the festival and conducts business activities and another one whose main role is to promote young artists and to organize workshops and competitions. While the former foundation is required to pay taxes, the latter benefits from a tax-exempt status due to its philanthropic, public-utility purpose.

Besides that solution, Prof. Oberson shares 3 other possibilities for tax-exempt nonprofit organizations to pursue business activities:

- 1) Ancillary business activity: in which case the main activity of the organization is charitable and the business activity is supporting the primary, philanthropic activities of the organization but can only be ancillary
- 2) Foundation holding: in which case the public-utility foundation holds shares of an organization that conducts business activities. In this case the governance of both entities has to be independent and the economic entity has to be devoted to support the foundation and therefore has to regularly pay dividend
- 3) Partial exemption: in which case the foundation pursues business activities subject to taxes while the non-economic activities of the foundation are tax exempt. This schema requires a strict distinction (and accounting) between the two types of activities and is complicated to implement.

Finally, Prof. Oberson addresses the delicate issue of the value-added tax (VAT). Due to the improvement of the Swiss legal landscape, most of the activities conducted by philanthropic foundations are exempt from VAT. However, VAT remains one of the traps for philanthropy, as foundations still need to pay VAT as a result of the reverse charge mechanism in case they benefit from services from abroad.

Dr. Raphaël Gani

Dr. Gani pursues the discussion about whether public-utility or public-service goal can be reconciled with a business activity and how it is treated in Switzerland.

The main points made by Dr. Gani are:

- 1) in the case law, the emphasis is often put on the “side” conditions related to the nonprofit organization’s tax-exempt status rather than on the organization’s business activity;
- 2) social economy will challenge the current environment, but it is not yet in courts.

Dr. Gani recaps the conditions for nonprofit organizations to benefit from tax exempt status and highlights that nonprofit organizations need to pay attention to additional conditions if they pursue business activities based on whether the entity has a public-service or a pure public-utility purpose.



First, public-purpose organizations (see the recent Supreme Court decision 2C_206/2018 23rd July 2019) cannot distribute their profits deriving from business activities to their shareholders, even if these are state (public) entities.

Second, pure public-utility organizations need to be aware of 3 obstacles in case they pursue business activities:

- 1) They need to have a public-interest purpose, which has to be understood as the interest of the community as a whole (see the recent Supreme Court 2C_147/2019 20th August 2019 which gives a narrow interpretation of that concept; see also the case study on slides 39-40)
- 2) They need to benefit to an open circle of beneficiaries (see the Supreme Court 2C_592/2008 2nd February 2009; see also the case study on slides 32-35)
- 3) They need to make sacrifices for the greater public good if needed and this must be also reflected in the remuneration of the members of the governing body

Dr. Gani concludes by highlighting that practitioners need to keep in mind that not only commercial activities, but also other conditions are relevant to the effect of obtaining tax exemption. He mentions another interesting case about new and innovative entities. While an increasing number of nonprofit organizations - which enjoy a tax-exempt status - is having recourse to fundraising and developing scientific research, such nonprofit organizations might face challenges in order not to lose their tax-exempt status while pursuing business activities by selling their innovative products. This issue might undermine flourishing of innovative businesses and social enterprises in general.

Q&A

The following questions are raised by the audience:

- What the legal framework is for the UK-based international charities/nonprofit organizations with EU-based subsidiaries and how BREXIT would impact such organizations within the European Union?
- How the accumulation of income is tested by tax authorities?
- How relatively vague terms can be defined, such as culture?
- How nonprofit organizations can manage both their business and philanthropic activities, if a donor gives conditional grants (ex. supports 75% of the costs of the project only if a nonprofit entity fundraises or earns the rest of 25%)?
- How new, hybrid organizations and innovative vehicles (such as B Corps) can tackle the issue of business activities conducted by nonprofit organizations?

The speakers highlight that cross-border giving is a difficult question, but the European Court of Justice strengthened the non-discrimination principle on the tax treatment of philanthropy within the European Union by a series of key rulings such as ECJ 14.9.2006 - C-386/04 (Centro di Musicologia Walter Stauffer/Finanzamt München für Körperschaften), ECJ, 27. 1. 2009 - C-318/07 (Hein Persche/Finanzamt Lüdenscheid), and ECJ, 10. 2. 2011 - C-25/10 (Missionswerk Werner Heukelbach eV/Belgien).



In connection with coordinating a nonprofit organization's business and philanthropic activities, the speakers mention that this requires a pragmatic approach, focusing on the feasibility of its implementation. The different possibilities mentioned by Prof. Oberson during his presentation require careful planning and implementation. In case of a significant business activity, a previous discussion with tax authorities is advisable.

Finally, as new and innovative philanthropic vehicles – such as B Corps, social impact investing, online and digital giving – are on the rise, they might require further regulation to create a more transparent and safer environment for philanthropy. Also, practitioners need to remember that enjoying a tax-exempt status is important not only for the nonprofit organizations, but also for their donors.

CONCLUSION

Based on what has been said by the 3 speakers, Prof. Peter concludes by sharing some thoughts with the audience. He preliminarily submits that the quality of the discussion and the questions from the audience confirm the need for research that addresses several questions relating to the interaction between taxation and philanthropy. Interestingly, each of the 4 aforesaid questions identified by the GCP in the context of its current taxation and philanthropy research project has been touched upon although, obviously, not solved:

- It is likely that it is economically justified to grant tax incentives to philanthropic initiatives in order to promote them, even though measuring their real impact is extremely difficult;
- There are several possibilities to create a more effective system; the panel gave some interesting examples coming from the Netherlands and Switzerland;
- Cross-border philanthropy is a difficult topic, but it necessarily has to be addressed in an increasingly globalized world;
- New vehicles ranging from hybrid organizations to social enterprises are of a growing importance and their tax treatment has to be addressed if it is (as it probably should) considered that they should be stimulated.

Prof. Peter thanks the speakers for their presentations, which incidentally highlight the importance of bringing together research and practice. He identifies 4 questions that might be addressed by researchers and practitioners, as well as by the tax administrations.

- Is there really a rationale requiring that organizations enjoying tax-exempt status can only pursue ancillary business activities? Should the decisive factor be the destination of funds rather than their source?
- Is the requirement that board members' cannot be remunerated justified?
- Is the requirement that holding companies cannot be involved in the board of directors of their affiliated entities justified?
- Corporate Social Responsibility (CSR) is now a well-established principle and a growing societal requirement; can it also be said that there is now, in addition or as part thereof, something that could be called a "Tax social responsibility" (TSR)?



Prof. Peter then invites the speakers and audience to join him and his colleagues to celebrate the 2nd birthday of the GCP, which was indeed launched on 11 September 2017.

UPDATE

Mrs. Laetitia Gill, Executive Director of the GCP, concludes by thanking the panel and guests, and in highlighting the new courses and next events in the 2019 Fall Semester.

For more detailed information on the GCP activities (teaching, research and publication, events), please visit the website: www.unige.ch/philanthropie