

ICCSL Comments
on
Knesset Bill
on disclosure requirements
for recipients of support
from a foreign political entity - 2010

In the State of Israel, there are four primary types of not-for-profit organizations (NPOs), each with different requirements for formation, membership, and public purpose. These include:

- Associations (*Amutot*, singular *Amuta*), governed by the Law of Associations, 1980;
- Private Companies for Public Benefit, governed by the Companies Act, 1999;
- Cooperative Societies, governed by the Cooperative Societies Ordinance, 1933; and
- Endowments, governed by the Trust Law, 1979.

The tax laws in Israel treat all NPOs the same, regardless of their method of formation or incorporation. Tax implications are governed by the Income Tax Ordinance and the Value Added Tax Law. *Amutot* – **which are the aim of the proposed legislation** -- are considered bodies corporate under Israeli law (*Amutot* Law, section 8); hence they will be subject to the planned change in tax status for recipients of support from a foreign political entity as proposed in the **Knesset Bill on disclosure requirements for recipients of support from a foreign political entity – 2010**.

Under section 10 (b) of the proposed legislation: “A corporation which is a recipient of support will not be considered a public institution as defined by section 9(2) of the Income Tax Ordinance.” This means that in addition to the onerous reporting rules to be imposed on organizations receiving “monetary support from a foreign political entity for the purpose of funding political activities in Israel.” Although entities that have “diplomatic or consular representation of a foreign state that enjoys diplomatic immunity” (e.g., USAID, GTZ, DfID, CIDA, etc.) are excluded from the definition of “foreign political entity,” various entities that do not have such status might be included (for example, the National Democratic Institute or the political party foundations in Germany).

According to the Israeli Center for Third Sector Research (ICTR), “there are currently over 34,000 registered Third Sector organizations in Israel, about half of which are active. Most of these are “*amutot*” (non-profit associations), many of them provide services. However, the number of funding organizations (foundations) and advocacy groups is growing. An average of 1,500 new organizations are registered annually....Israel’s Third Sector emphasizes classic welfare services, with 84% of the Sector’s economic activity in the fields of health, education and welfare. Public funding is the Third Sector’s main revenue source (55%), and more than a quarter of Israeli Third Sector organizations received government support in 2001.”

Explanation of Detrimental Impact of the Bill if Passed¹

Income Tax Exemption in Israel in General

The Income Tax Ordinance (ITO) [New Version] grants tax exemptions to organizations that qualify as “public institutions.” To determine which organizations may be recognized as public institutions, it is important to examine the legal structure and public aims of the organization as well as the activities in which it is engaged. Generally, any activity involving religion, culture, education, science, health, welfare, sport, or any other objective approved by the Minister of Finance constitutes a public purpose under the ITO section 9 (2).

This means that in order for a foreign or an Israeli donor to deduct contributions to an Israeli NPO, that organization must be qualified as a “public institution.” The following are the criteria for an *amuta* to be eligible for recognition as a “public institution” under section 9(2) of the ITO:

- The *amuta* was created for a “public purpose” as defined in section 9(2) – i.e., religion, culture, education, science, health, caretaking, sport, or any other purpose approved by the Minister of Finance; the Minister of Finance has given approval to such matters as assistance to struggling towns, encouragement of settlement in Judea and Samaria and environmental protection.
- The *amuta* does not conduct any substantial part of its operation other than for a public purpose (this is required to enable the *amuta* to offer tax deductions for donations made to it, pursuant to section 46(a) of the ITO.)
- The *amuta* comprises at least seven members, as opposed to the minimum of two members sufficient for establishing an *amuta* under the *Amutot* Law.
- The majority of the *amuta*’s members are not related one to another (‘related’ is defined as a spouse, sibling, parent, grandparent, descendant, spouse’s descendant, and spouse of any of the above.)
- The *amuta* has included in its Articles of Association a provision according to which its assets and revenues are to be used solely for its public purposes; any distribution of profits or special benefits in any form to members is prohibited.
- The *amuta* has included in its articles a provision that upon liquidation the assets of the *amuta* will be transferred to another public institution within the meaning of section 9(2) of the ITO and will not be distributed among the members. Note that where an *amuta* adopts the “Model Articles of Association” (Schedule 1 to the *Amutot* Law) the standard practice is that section 21 of the Model Articles is amended regarding the non-distribution of profits and section 22 is added regarding assets upon liquidation, in order to conform to the statutory definition of a “public institution” within the meaning of the ITO. The Registrar of *Amutot* is notified of such amendment, usually at the same time as the registration of the *amuta* is applied for. An *amuta* is deemed to have adopted the Model Articles if it does not submit its own Articles upon registration.
- The *amuta* submits annual reports regarding assets, income and expenses in the prescribed form. This is further required for an *amuta* as a public organisation in

¹ Caveat: This is a statement of talking points. It is not designed to give legal advice.

order to offer tax deductions on donations made to it pursuant to Section 46(a) of the Income Tax Ordinance.

An *amuta* is created to operate in the chosen field for a chosen public purpose and not for a specific *ad hoc* case.

The proposed legislation will add significant reporting obligations for all *amutot* in Israel that receive foreign funding of any sort. For example, an *amuta* registered with the Registrar of *Amutot*, would also have to register with the Registrar of Political Parties under section 2 of the Bill, which states “The political parties’ registrar should also act as the registrar of the recipient of support of foreign entities (hereinafter – the registrar).” In addition, significant reporting duties would be imposed on the recipient of foreign funds. For example, section 6 provides as follows: “Immediately following the receipt of monetary support from the foreign political entity, the recipient of support will provide a signed financial report to the registrar detailing the following:

1. Identity of the donor;
2. Amount donated;
3. Purpose of the support or its designation; and
4. Obligations on the part of the recipient of support, provided to the foreign political entity orally or in writing, if any exist.”

And there are other obligations for reporting and transparency as well. In some sense this may not be a bad thing, as it will make it clear when an Israeli NPO receives foreign support for political activities, but numerous Israeli NPOs have objected to the bill, according to a report in the [Jerusalem Post of February 15, 2010](#). These organizations state that they are already fully transparent. In addition, it is the change in status for such a NPO that could have real and lasting implications for civil society in Israel because it may result in a loss of charitable contributions to such entities from both domestic and foreign donors.²

Income Tax Deductions

Israel:

Donations to a public institutions recognized by the Minister of Finance and the Knesset Finance Committee are tax deductible for the donor pursuant to section 46(a) of the ITO (35% for amount over NIS 370, but the overall deduction limited to 30% of the donor’s taxable income). If an organization is classified as not being a public institution, these funds will dry up. Thus, although Israel’s NPOs are principally government funded (55%) (according to the ICTR), many other sources of funds, including individual and corporate donations, as well as foreign funds, are needed to keep them alive. Keeping channels open to such sources of funds is crucial for Israel’s civil society.

² An article in *Arutz Sheva* discloses this as the underlying political issue at stake. See [Expert Calls for Law Against Foreign Political Intervention - Defense/Middle East - Israel News - Israel National News](#).

U.S.:

Corporations

On January 1, 1995, the 1975 U.S.-Israel Income Tax Treaty (“Israel Tax Treaty”) took effect. Article 15A of a 1980 Protocol to the treaty allows U.S. donors to deduct contributions to Israeli charities as long as the charitable organization would have qualified for exemption according to U.S. standards. The Israel Tax Treaty fixes the percentage limitation on charitable deductions at 25%. This percentage is calculated according to the amount of income the U.S. donor has from sources within Israel. The treaty provision makes it easier for some U.S. grant-makers – those with business in Israel – to make grants to Israeli charities. But, if the Israeli *amutot* are not classified as “public institutions,” this source of funds will also dry up.

Individuals

U.S. individuals are not permitted to take deductions for charitable contributions to foreign organizations, but they may make such deductible contributions to U.S. public charities which are organizations that qualify as “friends of” organizations under U.S. law and that transfer funds into Israel. Many of these exist to support Israel and Israeli NPOs.

Since the USA Patriot Act was passed, international grant-making for individuals from donor-advised assets (e.g. a United Way type organization or other such fund where the donor directs where the money goes) now requires equivalency determination or expenditure responsibility (see below under Foundations). In other words, entities that U.S. organizations support are required to be the equivalent of U.S. charities (tax exempt under section Internal Revenue Code (IRC) section 501(c) (3)) or the donor organization is required to exercise expenditure responsibility. Thus, if an Israeli *amuta* did not qualify as a “public institution,” American individuals would be unlikely to make contributions to a U.S. organization that supported it.

The suggested approach by the Council on Foundations (the leading industry group for American grant-makers) for public charities that do **not** use donor-advised funds (such as UJA-Federation) for their international grant-making is as follows:

- Obtain English copies of organizational documents and a description of the activities and programs of the grantee.
- Enter into a specific written agreement, documenting the grantee’s commitments and the use of funds for charitable purposes.
- Obtain a yearly accounting of the funds for each year until the funds are expended.

Foundations

The rules for U.S. private foundations making grants to overseas entities are very strict and are even stricter in light of the USA Patriot Act’s provisions on “terrorist financing.” In general, U.S. foundations must either satisfy themselves that a foreign entity is the equivalent of a U.S. charity or they must exercise “expenditure responsibility” with regard to a foreign grant. Since an *amuta* that does not qualify as a “public institution” will not be the equivalent of a U.S. charity, the equivalency determination will not be possible. Thus, a foundation would have to exercise expenditure responsibility to make a grant to such an *amuta*. The advantages and

disadvantages of each form of grant-making are described at <http://www.usig.org/legal/er-ed-intro.asp>.

Other Common Law Jurisdictions such as **England** and **Canada** would tend to follow U.S. law, but with their own specific wrinkles. The common law rule forbidding political activities by charities is shared by them, which means that political activities of a large amount would disqualify any organization – foreign or domestic -- from being the recipient of tax deductible contributions.

Civil Law Jurisdictions in Europe

Much of the information available on the website of the European Foundation Centre and the King Baudouin Foundation (which publishes a database on European countries and their laws affecting giving) deals only with giving across borders within Europe. From the requirements for the deductibility of charitable contributions within Europe (that an organization be similar to a charity in the home country), it can easily be surmised that giving outside Europe would require the same identification of an organization as a charity under local law. Thus, the following countries might restrict giving to Israeli organizations that are classed as “non-public” institutions.

Germany:

Although the law is very complex with regard to the administration of the typical registered association or foundation in Germany, the specific treatment of political activities can be found in only two places in German law. There are restrictions in the civil law regarding associations, and there are restrictions in the tax law regarding all corporate bodies that are involved in charitable and public benefit activities. Like most civil law countries, Germany has two types of not-for-profit organizations that may generally engage in what the common law refers to as charity. These are the association (*Verein*), referred to in the Bürgerliches Gesetzbuch (BGB) 1; 21 ff, and the foundation (*Stiftung*), referred to in BGB 1; 80 ff. It is also possible to register NPOs in the GmbH (limited liability) or AG (stock company) corporate forms, but there is no need to go into those details for purposes of this short synopsis.

The civil law restrictions set out in the Association Law (*Vereinsgesetz*) are quite limited and apply only to registered associations with a significant number or foreign persons as members or leaders. The tax law restrictions are more important, because they apply to all corporate organizations that engage in public benefit activities. Here the situation is a bit complex when one compares it with common law jurisdictions such as the U.S; because the general tax (fiscal) law (*Abgabenordnung* or *AO*) refers to “charitable” (*mildtätige*), “public benefit” (*gemeinnützige*), and “religious” (*kirchliche*) purposes, and defines each of them with a list of permitted purposes.

While the term “charitable” in AO § 53 permits a fairly limited group of purposes, e.g., organizations that care for the sick, the handicapped, the homeless, etc.,³ the “public benefit” term used in AO § 52 more nearly encompasses the broader range of purposes referred to as

³ These do receive greater tax benefits, e.g., a higher limit on deductible donations.

“charity” in the common law system. In addition, AO § 54, which deals with religious activities, comprises many religious purposes dealt with in common law jurisdictions. In this discussion, therefore, the “public benefit” category is treated as essentially defining the broad concept of charity used in the common law. The major reason for this is that this category has some restrictions with respect to political activities, while the other two do not. In fact, however, there is a built-in logic to this treatment – most Germans would not think that an organization providing a home for the homeless would engage in any prohibited political activity as described below. Nor would an organization that trains clergy. Thus, providing the limits on political activities ONLY for the broader “public benefit” class makes a lot of sense to the German way of thinking.

The restrictions on political activities of tax exempt “public benefit” organizations are found in the regulations interpreting the AO § 52 (*Anwendungserlass zur Abgabenordnung -- AEAO 800*). These regulations state quite clearly that political purposes “are fundamentally not” public benefit purposes. On the other hand, “political” is fairly narrowly defined by the regulations. Although it specifically includes trying to influence public opinion and supporting political parties, the regulations go on to say that a certain amount of “influencing public opinion” is permissible for “public benefit” organizations. In fact, it is permissible so long as the accomplishment of a public benefit purpose is linked with setting a political goal, and the actual attempts to influence the political parties and the state are not foremost in what the organization does. The regulations go on to cite a specific case, which held that an organization could take a specific political position, consistent with its public benefit purposes, so long as that was not its primary activity. In contrast, an organization that has the political goal as its only or its primary purpose would fail as a public benefit organization. The rules are thus quite unrestrictive and would seem to permit considerable purpose-related advocacy and lobbying.

This suggests that a German donor might be able to take a charitable contribution deduction for a donation to an Israeli NPO, provided that it qualified as public benefit organization, which would be one that qualified as a public institution under Israeli law. But presumably it would not apply to a donation to an organization that loses that status.

France:

Associations and foundations obtain recognition of “public benefit” status by the *Conseil d’Etat* (France’s Highest Administrative Court). Nothing in the law specifically says that a “public benefit organization” may not engage in political activities, but a decision by the *Conseil d’Etat*, (sect. Interior 18-12-1979 n° 326214) clarifies that organizations with a primarily political purpose, such as engaging primarily in political advocacy, cannot be recognized as public benefit organizations. (Political organizations cannot be considered to be carrying out activities of general interest and therefore do not qualify for the status).

Political organizations cannot qualify for “charitable” status under either the tax law or the administrative law. As a result, if the political activities of a “charitable” organization were to increase to the extent that the administrative authorities would consider it to be in violation of its charter, the organization would risk losing its “charitable” status.

Conclusion

It is, of course, possible that individual donors will continue to make contributions even if they cannot deduct them. It is, however, unlikely that a tax adviser would give advice that a large gift should be made without being deductible to the donor. Neither corporations (which must maximize profits for shareholders) nor U.S. private foundations could be involved in making gifts/grants to entities that are in effect classified as political parties. Thus, the legislation would accomplish the purpose of shuttering many left-wing critics of the Israeli government.