

Pending U.S.- Mexican Tax Convention and Nonprofit Sectors

By James W. Wilkie

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Incorporating provisions suggested to the treasury ministries of Mexico and the United States in early 1992 by the committee on Trilateral Philanthropy of the Council of Foundations (COF), tax authorities of the two countries have coordinated to take advantage of the legal reform in Mexico's philanthropic sector. The philanthropic provisions are not incorporated into NAFTA negotiations but rather are included in the U.S.- Mexican Treaty on Double Taxation, the first of its kind signed by the United States with any Latin American country. The treaty is intended to eliminate taxes which cover the same income in both countries thus removing another obstacle to the free flow of capital and merchandise. Further, the treaty is aimed at preventing tax evasion.

In research for the Trilateral Committee, PROFMEX President **James W. Wilkie** found that negotiators for the U.S.- Mexican Treaty on Double Taxation were willing to add important and unprecedented provisions to facilitate cross-border philanthropy. COF President **James A. Joseph** then went to Mexico at the invitation of the Centro Mexicano para la Filantropía to encourage reform of Mexico's nonprofit sector and win cooperation from the Mexican Treasury Department to include mutual recognition of nonprofit sectors in the Double Taxation Treaty.

At all time, the provisions were formally developed for incorporation into tax negotiations between the two countries. (See the accompanying article on "Mexico's New Nonprofit Sector.").

Development of the nonprofit provisions in the Double Taxation Treaty were led by **Thomas A. Troyer** (Caplin & Drysdale, Washington, D.C.) and **Emilio Romano** (Mexican Treasury Department Representative, Mexican Embassy, Washington). Their successful work was included in the treaty which was signed September 18, 1992, in Washington, D.C. The treaty is now pending action in the U.S. Senate, with hearing scheduled probably for late October or early November.

Troyer, in his capacity as legal counsel to the Trilateral Committee, developed the following statement, which was approved for release by the Committee at its New York City meeting on March 20, 1993. The Statement address specific problems to which the treaty provides solutions.

Troyer Statement on the Tax Provisions

Under the treaty, Mexican and U.S. tax authorities agree to recognize ex-emption of each other's philanthropic organizations (including educational, scientific, and charitable institutions) if they meet certain standards and give reciprocal favorable treatment to grants and contributions to those organizations. The Mexican government has taken the

steps necessary to adopt and implement new legislation-Article 70-B of the Mexican Income Tax Law- coordinated with the treaty provisions and closely parallel to United States tax concepts.

The basic concept is to recognize that the public philanthropy rules of the United States tax law and the new Article 70-B provisions of Mexican tax law are essentially equivalent standards for philanthropies and that, therefore, once Mexico has determined that a Mexican Organization satisfies Mexican law, the United States should recognize that determination for U.S. tax purposes, while Mexico should respond with equivalent reciprocal treatment of U.S. organizations.

The specific problems addressed by the treaty provisions, and the solutions offered by the treaty provisions and the new Mexican law are:

A. Grants to Mexican organizations.

Problem: The United States Internal Revenue Service (IRS) does not normally recognize tax exemption determinations of other countries. Therefore, under current law, U.S. foundations (private or public) have to go through a generally cumbersome and daunting process to establish that Mexican organizations are eligible for grants.

Solution: Under current law, U.S. taxpayers having income from Mexico subject to U.S. tax cannot take U.S. contribution deductions for gifts to Mexican philanthropic organizations.

Solution: Under the treaty, U.S. grantors could rely on Mexican determinations of the status of Mexican grantee organizations.

B. Individual tax deductions.

Problem: Under current law, U.S. taxpayers having income from Mexico subject to U.S. tax cannot take U.S. contribution deductions for gifts to Mexican philanthropic organizations.

Solution: Under the new treaty, Mexican organizations determined by Mexico to meet the new Mexican standards would be eligible to receive contributions deductible by the U.S. taxpayers for U.S. tax purposes, up to defined percentages of the U.S. taxpayers' income from Mexican sources.

C. Exemptions for organizations.

Problem: Under current law, Mexican philanthropic organizations are subject to U.S. taxation on their U.S. income unless they establish with the IRS their qualification for exemption under U.S. law.

Solution: Mexican philanthropic organizations qualified under Mexican law would be exempt from U.S. income tax to the same extent they are exempt in Mexico. In addition, Mexican private foundations would be exempt from U.S. excise taxes on private foundations.

In each case, Mexico would afford equivalent benefits under Mexican tax law to U.S. organizations which the IRS has recognized as public philanthropic organizations under U.S. law.

The key to these provisions is explicit reciprocal recognition of each other's determinations of the philanthropic status of organizations. No such mutual recognition has been required under other tax treaties, and its absence has made meaningless provisions in other treaties similar objectives.

Troyer Summary of Next Steps to Gain U.S. Treaty Approval

As is to be expected, there are three things to be done:

- (1) Most important and difficult, the U.S. Senate must ratify the Convention. A major effort must be undertaken to convince the Foreign Relations Committee, the Joint Committee, and other Congressional staffs, as well as individual Senators to explain that the article on philanthropy is highly beneficial for U.S.-Mexican relations and, for that and other reasons, for the United States. Traditionally, the Senate has objected to treaty provisions giving U.S. taxpayers favorable treatment under U.S. tax law and, in particular, allowing charitable contribution deductions for gifts to foreign philanthropic organizations. Supporters will need to convince the U.S. Senate that including these provisions in the Mexican treaty is a good thing in itself, and that the Mexican case is sufficiently different that it need not necessarily set a precedent for other treaties.
- (2) The Mexican regulations under Article 70-B, which are about to be proposed, need to be reviewed by the U.S. side. Caplin & Drysdale is working with the Treasury Department and the IRS to explain the draft Mexican regulations and address any problems that emerge.
- (3) A provision in the Protocol giving each country the right to refuse recognition of the other's determinations in particular cases (which both countries wanted) needs to be limited to abuse cases, at least for retroactive denial of benefits. Caplin & Drysdale is working with Mexican authorities and the Treasury Department to resolve this problem.

COF Washington Coordination for Treaty Approval

Troyer, assisted by COF's **John A. Edie** and **Christopher M. Harris**, is coordinating information about the treaty approval process which will especially require communication with the following U.S. Senators:

Committee on Foreign Relations, United States Senate

Claiborne Pell, (Rhode Island), Chairman

Joseph R. Biden, Jr., Delaware

Paul S. Sarbanes, Maryland

Christopher J. Dodd, Connecticut

John F. Kerry, Massachusetts

Paul L. Simon, Illinois

Daniel P. Moynihan, New York

Charles S. Robb, Virginia

Marris Wofford, Pennsylvania

Russell D. Feingold, Wisconsin

Earlan Mathews, Tennessee

Jesse Helms, North Carolina

Richard G. Lugar, Indiana

Nancy L. Kassebaum, Kansas

Larry Pressler, South Dakota

Frank H. Murkowski, Alaska

Hank Brown, Colorado

James M. Jeffords, Vermont

Paul Coverdell, Georgia

Harlan Mathews, Tennessee

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