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Supreme Financial Authorities of the States

Law on Public Welfare Status

1. Issuance of provisional certificates regarding Public Welfare status
2. Appropriateness of expenditures for administration and requests for donations

Meeting KSt/GewSt I/00 - TOP I/21¹

The BFH [National Finance Office] has decided with its decree of 23 September 1998 – I B 82/98 that

- I. a public welfare corporation under specific conditions has a claim to the issuance of a provisional certificate regarding public welfare status, and
- II. a corporation is breaking the Law on Non-Profit Status (§ 55 AO) if it does not use the donations received primarily for tax-advantaged purposes as set out in its bylaws.

Considering the result of the discussion with the supreme financial authorities of the states, I take the following position regarding the application of the basic legal framework of this decree:

1. Provisional Certificates

1. According to the decree on applicability of AO, § 59 no. 4 and 5, the Finance Office, upon application, is to issue a provisional certificate regarding Public Welfare status to a corporation for which the qualification for tax-advantaged status has not yet been determined in the assessment process (regarding newly founded corporations),

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if the bylaws that have been submitted satisfy the demands of the law on Public Welfare status. The certificate is to be issued in a timely fashion and may be cancelled at any time. In particular it entitles the corporation to receive tax-advantaged contributions even before the end of the first assessment period.

This procedure will continue. The provisional certificate on Public Welfare status is to be issued in these cases (newly formed corporations) on form Gem 5.

2. According to the decree of the national Finance Office of 23 September 1998, the issuance of a provisional certification regarding Public Welfare status can also be considered if a corporation has been in existence for some time and its Public Welfare status has been denied in the assessment process.
 - a) A provisional certificate regarding Public Welfare status is to be issued, upon application, in those cases where the corporation will likely fulfill the conditions of Public Welfare status for the entire assessment period following the assessment period of the denial. Its validity shall not exceed 18 months.
 - b) Moreover, the issuance of a temporary certification of Public Welfare status may also be granted if the corporation is not a Public Welfare entity in the opinion of the Finance Department. In such cases the certificate may be issued only if the following conditions are met:
 - aa) The corporation must have filed for legal protection with the responsible Finance Court against a decision of the Finance Office in which the issuance of a temporary certificate of Public Welfare status has been denied.
 - bb) Serious doubts must exist as to whether the denial of Public Welfare status will be upheld in the proceedings. This means that the corporation conclusively and credibly shows that it meets the conditions for Public Welfare status in its bylaws and in its actual day-to-day activity.

cc) The economic status of the corporation must be threatened as a result of the non-issuance of the provisional certificate. The individual circumstances will determine the decision in each case. A threat to the corporation's existence cannot be supported merely because hitherto the corporation has supported itself in large measure on donations or on tax-deductible membership dues, and now because of the denial of certification for tax-advantaged contributions a significant decline of income is to be expected. A threat to the corporation's existence also does not exist if the corporation has sufficient available funds or can obtain necessary credit. As grounds for the application, the corporation must make the threat to its existence conclusive and credible.

The provisional certification of Public Welfare status will be issued under no. 2 letter b without a special form. It must put the corporation in the situation of being able to ask for donations on the basis of tax deductibility. The term of the certification is to last until the rendering of a legal decision in the case. The circumstances of each individual case will determine whether conditions imposed are reasonable and necessary, such as the national Finance Office has decided in the case at issue (including quarterly submission of reports on income and expenses).

II. Appropriateness of Administrative Expenses

1. A corporation cannot be considered as a Public Welfare agency if its expenses for general administration, including appeals for donations, exceed a reasonable amount (§ 55 section 1 no. 1 and 3 AO). According to the decision of the national Finance Office of 23 September 1998, this amount is exceeded when a corporation which is largely financed by monetary donations after a growth phase uses these donations primarily to finance expenses for administration and appeals for donations instead of for the pursuit of the tax-advantaged goals as set out in the bylaws. The national Finance Office has compared the amount of administrative expense, including appeals for donations, to the amount of donations received. Consequently, one should generalize from this that administrative expenses, including appeals for donations, should be judged in proportion to the total received amounts (donations, membership donations, grants, profits from economic enterprises, etc.).

The national Finance Office with this decision has not set a general limit of 50% for the appropriateness of administrative expenses, including appeals for donations. More to the point, as one may deduce from the reasoning of this decision, the particular circumstances of each individual case determine the question of the appropriateness of expenses. The use of funds detrimental to Public Welfare status can therefore occur even at a much lower percentage level of administrative expenses.

If a corporation uses its funds for advertising for new members, as a rule there should be no problem if no more than 10 percent of the total membership dues are used for this purpose each year.

2. During the founding or growth phase of a corporation, the use of a major part of funds for administrative expenses and appeals for donations may not be harmful to Public Welfare status. The length of the founding or growth phase during which these larger expenses are permissible depends on the circumstances of each individual case.

In the case decided here, the national Finance Office did not complain about the fact that the expenses of the corporation for administration and appeals for donations far surpassed the boundary of 50% of the monetary donations in the first four years after the founding; only from the fifth year on did it demand maintenance of this limit. However, it cannot be concluded from this case that in general permission must be given for a growth phase of four years in which there are proportionally higher expenses for administration and appeals for donations. In the case decided here, the national Finance Office also took into account, in addition to the special tasks and the structure of the corporation, that a second growth phase was necessary after denial of Public Welfare status had caused a sharp reduction in donations. Therefore, the four-year period allowed by the national Finance Office is to be understood as an upper limit. As a rule one should plan on a shorter growth phase.

3. Attention is drawn to the fact that Public Welfare status also is to be denied in the case where there is no objection to the relationship of administrative expenses to expenses for tax-advantaged purposes, but one particular administrative expense is not appropriate (e.g., the salary of the executive officer or outlays for appeals for members and donations) (§ 55 Section 1 no. 1 and 3 AO).

4. According to the explanations of the national Finance Office in the decision of 23 September 1998, expenses for salaries and fringe benefits (personnel costs) of administration and appeals for donations should be maintained appropriate to the working time spent on these activities. One should take note in this regard that costs for the work of an executive director should be treated basically as administrative expenses. A categorization of the costs of the director as part of the Public Welfare activity is possible only insofar as the executive director is directly involved in Public Welfare projects. The same reasoning applies to the categorization of travel costs.

This document will be published in the Bundessteuerblatt [national tax newsletter] part I and at the same time as the decision of the national Finance Office decision of 23 September 1998 in the Bundessteuerblatt part II.

For

Sarrazin

Attested

Public Official