OVERSEAS GRANTMAKING IN THE FACE OF ANTI-TERRORIST FINANCING INITIATIVES

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I. Summary of Key Developments.

In the wake of the September 11, 2001, terrorist attack on the United States, numerous U.S. and foreign-government agencies have conducted extensive investigations of flows of funds. The goal of these investigations was to determine the sources of funding for al Qaeda and other terrorist movements, and whether any of that funding originated in the Unites States and, if so, from whom.

In an informal meeting with several U.S. charities representatives on January 16, 2003, a U.S. government official expressed his opinion that organized charities throughout the Islamic Diaspora are the second leading source of funds for terrorism. While no documentation was provided to corroborate this assertion, U.S.-government officials have taken several law-enforcement steps that focus on a small number of U.S. charities.

Specifically, U.S. federal government officials have acted to block the assets of three U.S. charities considered to have funded foreign recipient organizations ("FROs") designated as foreign terrorist organizations. The U.S. charities include Holy Land Foundation, Global Relief Foundation, and Benevolence International. Legal challenges brought against the blocking action have been unsuccessful. For example, on December 31, 2002, the U.S. Court of

[1] I thank Betsy Buchalter Adler, David A. Shevlin, and Jennifer Goldberg Reynoso for their review of and constructive comments on the first draft of this paper.

Appeals for the Seventh Circuit found that the Global Relief Foundation ("GRF") was subject to provisions of President George W. Bush's Executive Order 13224 (Sept. 23, 2001), as amended by the USA Patriot Act, Pub. L. 107-56, Title I, § 106, 115 Stat. 272 (Oct. 26, 2001). Specifically, GRF denied that any "foreign . . . national" had an "interest" in its assets within the meaning of the applicable authorities. In disagreeing, the Court found a beneficial interest by foreign nationals in the assets of that U.S. charity:

> The statute is designed to give the President means to control assets that could be used by enemy aliens. When an enemy holds the *beneficial* interest in property, that is a real risk even if a U.S. citizen is the legal owner. Consider for a moment what would happen if Osama bin Laden put all of his assets into a trust, under Illinois law, administered by a national bank. If the trust instrument directed the trustee to make the funds available for purchases of weapons to be used by al Qaeda, then foreign enemies of the United States would have an "interest" in these funds even though legal ownership would be vested in the bank. The situation is the same if al Qaeda incorporated a subsidiary in Delaware and transferred all of its funds to that corporation—something it could do without any al Qaeda operative setting foot in the United States. What sense could it make to treat al Qaeda's funds as open to seizure if administered by a German bank but not if administered by a Delaware corporation under terrorist control? Nothing in the text of the IEEPA [International Emergency Economic Powers Act] suggests that the United States' ability to respond to an external threat can be defeated so easily. Thus the focus must be on how assets could be controlled and used, not on bare legal ownership. GRF conducts its operations outside the United States; the funds are applied for the benefit of non-citizens and thus are covered . . . .[2]

On October 16, 2002, the House of Representatives passed H.R. 5603 to amend the Internal Revenue Code of 1986 to suspend the tax-exempt status and deny deductibility of gifts to any U.S. charity designated as a terrorist organization pursuant to an Executive Order or otherwise. Currently, the three U.S. charities whose assets have been blocked remain listed in IRS Publication 78 as eligible to receive tax-deductible contributions, although any person making such a donation could expect an inquiry from the FBI or other federal officials.

On November 7, 2002, the Treasury Department issued Press Release PO-3607 "Response to Inquiries from Arab American and American Muslim Communities for Guidance on Charitable Best Practices" and a seven-page

[2] *Global Relief Foundation, Inc. v. O'Neill* (Dec. 31, 2002) at pp. 7-8.

document entitled "U.S. Department of the Treasury Anti-Terrorist Financing Guidelines: *Voluntary* Best Practices for U.S.-Based Charities." The press release states in part:

> The goal of blocking orders is to prevent financial resources from getting into the hands of terrorist organizations. It is important to prevent charities from being corrupted by terrorism. The blocking orders are not in any way intended to impede, restrict or scrutinize legitimate charitable giving. Indeed, the promotion of both faith-based and secular charitable giving is a central goal of this Administration.

The Best Practices document is described as being consistent with the principles espoused in both the private and international public sectors — e.g., the Better Business Bureau, the Evangelical Council for Financial Accountability and, most recently, the Financial Action Task Force, an international organization dedicated to combating money laundering through enhanced transparency in international financial transactions.

The Best Practices document is broken into four topics: Governance, Disclosure/Transparency in Governance and Finances, Financial Practice/Accountability, and Anti-Terrorist Financing Procedures.[3]

On January 27, 2003, R. Jeffrey Smith published an article in the Washington Post entitled "US Scrutiny of Overseas Charitable Donations Lax-Israel Probe of Money Funneled into Political Campaign Highlights Problem" (page A2). This article is a reminder that funds can be diverted for many noncharitable uses beyond supporting Middle Eastern terrorists, including political activity and supporting religious and ethnic movements from the Irish Republican Army to the Jewish Defense League to the Basque separatists.

On February 10, 2003, the executive director of Benevolence International pleaded guilty to racketeering conspiracy, admitting that he fraudulently obtained charitable donations in order to provide financial support to persons engaged in violent activities overseas. A Justice Department press release stated that Enaam M. Arnaout, a Syrian-born naturalized U.S. citizen, defrauded donors by leading them to believe their donations were used for peaceful, humanitarian purposes while a material amount of funds were diverted to persons overseas who were combatants in Chechnya and Bosnia.

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[3] For initial reactions and comments on the content of the Best Practices document, see J. Christine Harris "New Treasury Guidelines on Terrorist Funding Draw Criticism," Tax Notes (November 25, 2002) 1009 (copy attached).

On February 11, 2003, members of the ABA Section of Taxation's EO Committee submitted comments on proposed changes to Form 990. Principal responsibility was exercised by Betsy Buchalter Adler and Victoria B. Bjorklund. In pertinent part, those comments replied to the IRS request for comments on reporting foreign grants on IRS Form 990:

A. Foreign Grants

1. Should a separate schedule of grants to foreign organizations be required?

[11] Yes. We support this proposed change to Form 990. Currently, Form 990 requires filing organizations to report grants to other organizations in Part II, Statement of Functional Expenses, line 22, Grants and allocations, and to attach a schedule showing the name and address of the recipient and the class of activity furthered by the grant. Requiring filing organizations to provide this information on two separate schedules — one for organizations created or organized under United States law, and one for organizations organized under the laws of a jurisdiction other than the United States (a "Foreign Organization") — is an insignificant additional burden on the filing organization since this information is already required to be provided.

2. Should domestic charities conducting foreign activities be required to provide more specific information about the flow of funds involved in these activities, or about the recipients of these funds?

[12] It depends on the nature of the "more specific information" being requested and the purposes to which the information will be put. With regard to the "flow of funds," for example, the Voluntary Guidelines issued by the Department of the Treasury in November, 2002, suggest that charities may reduce the likelihood of a blocking order by obtaining and reviewing information about the banking arrangements of potential grantees and avoiding any transactions involving money-laundering jurisdictions or institutions. In our view, it is highly unlikely that even the largest and best-staffed American grant-making organizations would either be able to obtain from their potential grantees the detailed information suggested by the Voluntary Guideline as "best practices," or, once in their possession, be able to evaluate such information effectively. Moreover, in many parts of the world where the charitable American dollar contributes significantly to the public good, reliable and non-corrupt banking institutions comparable to American banks simply do not exist. American money can still contribute to the charitable good despite the absence of reliable banking institutions. We therefore question the benefit of seeking "more specific information." A November 12, 2002 *Wall Street Journal* article entitled, "Afghan Aid Flows Through Dark Channels: U.S. Is Forced to Move Funds in

Money-Transfer Networks Used by Terror Groups," by Michael M. Phillips, reported that American charities such as CARE and World Vision International depend on the informal "hawala" network in Pakistan and Afghanistan to get badly needed resources to legitimate charitable organizations, since the "hawala" network is the only dependable system available.

[13] While we understand the Service's reasons for considering this question, we suggest an alternate approach that we believe will better educate public charities as to their responsibilities in sending funds overseas for exempt purposes. First, we strongly suggest that the Service consider issuing new precedential guidance on this issue. The Service's authority on international grant-making by public charities dates from the 1960s. The most recent authorities, Rev. Rul. 63-252, 1963-2 C.B. 101, Rev. Rul. 66-79, 1966-1 C.B. 48, and G.C.M. 35319 (April 27, 1973), are decades old, and many public charities and practitioners are not familiar with them or consider them of historic interest only. In addition, these authorities approach the operational question from a deductibility perspective (whether the organization is a conduit with the result that the donor is not entitled to claim an income tax charitable deduction), which means that some organizations less concerned with deductibility take the position that these authorities do not apply to their operations. We would be happy to work with Treasury and the Service to draft new precedential guidance on this issue.

[14] Second, we suggest that Form 990 be amended to ask whether the filing organization has obtained from each foreign grantee a signed agreement limiting the use of grant funds to purposes and activities within the scope of Code Section 501(c)(3) and requiring the grantee to refrain from using the grant funds to support or promote violence or terrorist organizations. If the answer to that question is no, Form 990 could contain a follow-up question asking the filing organization to attach an explanation. This reporting requirement could apply to all grants to Foreign Organizations.

3. Should transactions other than grant-making, such as sales or leases where funds flow outside the United States, also be more extensively reported?

[15] We believe that asking questions on Form 990 is not the optimal means to gain useful information on sales or leases where funds flow outside the United States. We do believe, however, that it is appropriate for Form 990 to ask if a filing organization maintains a bank account outside the United States or its possessions and, if so, to identify the countries where it maintains such bank accounts. In addition, we note that an organization with a foreign bank account containing more than $10,000 is also required to file Form TD F90-22.1, Report of Foreign Bank and Financial Accounts.

On February 26, 2003, U.S. Attorney General John Ashcroft announced the indictment in Syracuse, New York, of four individuals and the Help the Needy organization. Charges include sending funds to Iraq without having obtained the required license to send funds into a listed country and other alleged violations, including laundering money to individuals in Iraq through accounts in Jordan Islamic Bank in Amman.

On March 4, 2003, a complaint unsealed in federal court in Brooklyn, New York, accused Mohammed Ali Hassan al Moayad of Yemen and his associates of raising and funneling $20 million to support al Qaeda. The complaint alleged that al Maoyad and an associate raised much of that money from U.S. contributors, including several New York business owners and the Al Farooq mosque in Brooklyn. Commenting on al Moayad's arrest in Germany, a spokesman for the American-Arab Anti-Discrimination league said that the Al Farooq mosque has a reputation as "host to people who have been extreme . . . . It's not unthinkable that somebody might try to use a mosque as a port for illegal activities. [4]

II. Statement of the Problem.

In considering how best to halt any improper flow of funds, federal officials must consider that such diversions (1) are likely a very tiny amount of the otherwise very valuable support for growth of democracy and democratic societies overseas, (2) are likely done intentionally by people with fanatical beliefs, (3) are illegal under existing laws, and (4) are difficult to trace because fanatics typically flout the rules and do not provide accurate reports and filings that would disclose their diversions. Another critical issue is the potential for greater abuse through religious organizations than through other structures.

If an individual were going to divert funds for terrorist purposes, he might be expected to elect to do so through a church, mosque, temple. The reasons are obvious: no Form 1023, no Forms 990, no state reports, no likelihood of audit so long as unrelated business taxable income is not at issue. In addition, persons who are motivated by religious fervor or extremism would more likely work through a church, temple or mosque where such fervor might be rewarded rather than bridled. The Treasury Department's November 2002 press release states that "the promotion of both faith-based and secular charitable giving is a central goal of this Administration." But the press release does not point out that it is far more difficult for the IRS, other regulators, the press and the public to track the activities of nonfiler religious organizations than it is to track those of filing organizations. It is, thus, not surprising that the three U.S. charities whose

[4] Verena Dobnik, "Terror Accusations Shake Brooklyn Mosque," AP, March 8, 2003.

assets were blocked were publicly supported charities that were not churches, because their acts and omissions were likely less difficult to trace and catch.

III. Who are the Funders of FROs?

Grantmakers and operating charities all expend charitable dollars outside the United States. Each category is subject to federal-tax rules (e.g., the anti-conduit rules, the expenditure responsibility rules) and state fiduciary law (e.g., the duty of loyalty, the duty of care), as well as criminal laws. Different categories of funders face different issues regarding diversion depending on such factors as their familiarity with the FRO and the amount of diligence justified by the size of the grant. Here is a summary of some of those issues.

A. *Grantmakers*

1. Private foundations — There are many different models of private-foundation funders. Some may give to their own in-country affiliates, known in-country partners, umbrella indigenous NGOs (which on-grant to smaller end users), or to indigenous NGOs which may themselves be end users or on-granters, or, less commonly, to individuals for travel, study, or other similar purposes (see § 4945 re: pre-approval), as consultants (not a grant requiring pre-approval), or as "charity" e.g., cash or goods to needy individuals (implicating Rev. Rul. 56-304 re: grants to individuals). Many corporate foundations match employee gifts, including gifts to FROs, and could not likely justify performing significant diligence on hundreds of small matching grants.

2. "American Friends of" organizations. I estimate that there are at least 800 such organizations which give primarily (but not exclusively) to "affiliated" overseas grantees on an on-going basis. Generally classified as public charities or supporting organizations, these organizations typically know their FROs very well.

3. Donor advised funds. It appears that relatively few sponsoring charities of donor advised funds make overseas grants. Most national donor advised funds will not approve recommendations for gifts to non-U.S. organizations. Many community foundations will not approve such recommendations because of policies or geographic restrictions on giving. A few sponsoring charities have explicitly elected to make advised gifts to FROs. Those that do include CAF America, American-Ireland Fund, Give2Asia, and the National Philanthropic Trust. At least three of those sponsoring charities have overseas affiliates who can assist with pre-grant review or oversight.

4. Other Public Charity Grantmakers. Many other public charities, including churches and schools, make grants to FROs that are incidental to principal operations in the United States.

B. *Operators: U.S. Organizations with Overseas Operations and/or Branch Offices*. These organizations can be public charities (CARE, World Vision International, IIE), private operating foundations (e.g., OSI), or private foundations (e.g., Ford, Rockefeller, Gates Foundations). Operators may also be grantmakers.

C. *Churches, Temples, and Mosques*. As these organizations do not file Form 990s, their overseas funding or operating activities are largely undocumented, unless self-reported in publicly-available materials or by the press. For example, the evangelist Pat Robertson has been reported to have invested hundreds of millions overseas in such activities as foreign religious broadcasting stations.

IV. Perceived Problems with Grants to FROs.

In considering how to halt diversions, one must consider the varied reasons that diversions occur. Here is a summary of some of those reasons.

A. *Intention to Commit Fraud on Donors or Otherwise Divert Funds to Non-Charitable Use*. Colonel Oliver North testified in the Iran-Contra hearings on the variety of ways a smart but ill-intentioned person could divert funds through multiple private foundations (he used 27). More recently, the blocked-asset cases cited above show that at least some small number of individuals have acquiesced in U.S. organizations' giving funds that the individuals intended or knew or later learned would be or had been diverted.

B. *Experienced vs. Novice Funders and Operators*. Funders and operators cover the widest possible range. Professionally-staffed, well-advised organizations with on-site staff and written contracts characterize practices on one end of the spectrum. Wire transfers or cash deliveries without written grant agreements or recordkeeping characterize the other end. One must assume that novices are most likely to conduct cash deliveries without records but recognize that ill-intentioned persons could easily move funds with confusing or no documentation.
Funds are Given for Proper Purposes but Diverted by Overseas Actors. Here the question becomes one of responsibility to track use of funds and how

far the funder is obligated to go and skilled enough to go. Betsy Adler has written, "The question is how far down the chain the funder/operator must go." For example, suppose a company foundation matches non-U.S. employee donations to their local affiliate of the Red Cross/Red Crescent by making a grant to the American Red Cross for international aid. Must the company foundation compel the local Red Cross/Red Crescent to provide it with the names of its subcontractors and subgrantees in order to generate matching funds for the international relief work of the American Red Cross?

C. *Funds from the U.S. Free up Funds for Illegal Purposes*. Sometimes FROs use U.S.-sourced funds for charitable purposes, while under the "money-is-fungible principle" freeing up dollars for other, noncharitable activities.

D. *Funds are used for allegedly humanitarian but offensive purposes*. This might apply, for example, to "humanitarian relief" provided to the families of suicide bombers after they have caused loss of life and grave injury. It might also apply to support of education that might, among other things, promote killing American citizens or overthrow of the U.S. government.

V. Possible Solutions.

At the conclusion of his January 16, 2003, meeting with charities representatives, a senior government official is reported to have said, "Let me know what would work." And at the ABA Section of Taxation EO meeting in January 2003, IRS EO Director Steve Miller encouraged commentators to submit feedback on the Voluntary Best Practices. As for timing, Miller urged that feedback be submitted as soon as possible.

Many minds are considering these issues. The Council on Foundations' Treasury Guidelines Task Force, under the guidance of Council on Foundations Acting General Counsel, Janne Gallagher, and outside counsel, Marc Owens, has led a group brainstorming and drafting effort that regularly includes at least 20 of the country's most experienced grantmakers to FROs and EO practitioners. As noted above, the Tax Section EO Committee included comments in the Form 990 submission and has scheduled two panels and a luncheon address by Prof. Harvey Dale for its May 9, 2003, meeting. A critical issue weighing on these and other drafters and commentators is the recognition that U.S. government officials have investigative capacities far exceeding those of charities. And without

knowing more about the specifics of the diversions that the U.S. government has discovered recently, it is hard to make comprehensive suggestions about possible solutions that would not be overly burdensome to "good" funders while failing to deter "bad" funders. Nonetheless, some actions are worthy of immediate consideration, including the following.

A. *New Revenue Rulings* or other precedential guidance clearly describing operating standards to which U.S. § 501(c)(3) organizations — whether funders, operators, private foundations, public charities, churches, experts or novices — will be held.

As noted in the EO Committee's Form 990 comments, I believe that this authority gap must be closed. The existing guidance is decades old. Public-charity authority was issued between 1963 and 1973 while the private foundation regulations were drafted at the same time. In addition to their age, the rulings and GCM follow a back-door approach: They address § 170 deductibility issues, not § 501(c)(3) operationality. We need § 501(c)(3) guidance so that organizations not concerned with deductibility cannot ignore it. Finally, we need 501(c)(3) guidance that is timely and relevant to 2003 concerns, not circa 1960 issues (which precede computers, wire transfers, faxes, global travel and connectivity). Funders and practitioners should be involved in the drafting of any such precedential guidance so that Treasury can benefit from state-of-the-art feedback.

B. *Require Written Documentation of Funds Destined for Expenditure Overseas*. At the least, every transfer to a FRO should be preceded by a written contract requiring use of the funds for qualifying § 501(c)(3) purposes and not for promotion of violence or terrorism. This documentation could be a grant-award contract for larger grants and a transmittal form for smaller gifts, such as corporate matching grants. And, the recipient should be required to make its own grantees and their grantees, if any, agree to the same requirements of a written contract and use limitations. All such contracts should require repayment of funds in the event that a diversion occurs. The global emergence of email makes this requirement of a writing much more practical in 2003 than in any prior era.

C. *Aid to Individuals*. Of course, in a disaster or emergency situation where aid is delivered directly to individuals, such writings as described above are not practical (e.g., relief supplies delivered in a refugee camp). The IRS issued practical guidance on recordkeeping for delivery of aid by organizations to individuals in the wake of September 11 and such

guidance could be expressly affirmed to overseas expenditures to individuals.

I believe strongly that the IRS should review Rev. Rul. 56-304 and either reissue it and revise it or release new guidance on grants to individuals. Such guidance should make clear that it applies to all of public charity, private foundation, and church funders. Of course, if the payor is a non-filer (e.g., under $25,000 in annual receipts, foreign organization, churches, or an individual who gives directly), consideration might be given to a requirement of filing a "gift return schedule" with the IRS requiring disclosure of the amount and general nature of aid to any individual in excess of $11,000 per year. (There might need to be protections against making multiple smaller gifts.) Such a requirement could have the behavior-modification effect of encouraging individuals to give through reporting organizations rather than directly. Whether such filings would be feasible or useful and whether they should apply only to gifts to non-U.S. individuals are open questions. (Aid to individuals may be abused anywhere, regardless of geography.) Disclosure by federal officials of whether aid to individuals is concerning would also be of help.

D. Reporting Back. Two decades of work with overseas grantmakers have convinced me that generally only U.S. charities typically expect reports back on how funds were used by FROs. In Western Europe, good accounts may be kept but funds are not typically traced between a specific funder and a specific expenditure. In Asia, the laws may be well written but are often not applied in practice. That having been said, I have had experience in investigating diversions of U.S. funds and their recovery from organizations in Indonesia, Pakistan, Israel and other countries. Based on those experiences, I recommend requiring a report on the use of significant grants (e.g., those in excess of some amount such as $50,000 per annum) or at least a report on the grantee's general expenditures for the year. Using such reports (augmented by local independent audits), I have been able to identify and help clients recover some diversions. Of course, where a foreign grantee intends to divert funds, even a well-conducted (and expensive) audit is not likely to be sufficient to identify disguised fraud.

In addition, some countries routinely audit charities at periodic intervals (e.g,. the Cour des Comptes in France). Those reports may be required to be made available to the public and can be instructive. Of course, it takes time and training to be able to study and draw conclusions from any report and such costs are not likely to be tolerated by smaller funders in general or by larger funders

for small grants (e.g., a sponsoring charity of a donor-advised fund for a small advised gift). Advice from money-laundering experts would also be helpful in deciding which, if any, burdens are worth imposing on funders and FROs.

E. *Encourage Incentives for Favored Relationships*. In my experience, an overseas recipient is most likely to expend responsibly and report back accurately on uses of U.S-sourced funds if the FRO enjoys the prospect of receiving new U.S.-sourced funds. This is most commonly the case with established "friends of" networks granting to one or a relatively small number of grantees (as opposed to a scatter-funder which might make one-time grants to many grantees). Such "friends of" organizations generally have sufficient clout to be able to get global grant-award contracts (the terms of which govern every amount transferred, no matter how small) or grant-by-grant contracts, as well as regular written reports. Such organizations are also most likely to invest resources in such activities as multiple overseas site visits, staff training, and occasional audits of the overseas recipient(s). In my experience, "friends of" funders may also attend planning meetings and participate in operations they have paid for. Similarly close relationships can exist between some professionally staffed foundation and public-charity funders and their FROs, outside a typical "friends of" network.

F. *Provide Feedback on the Voluntary Best Practices*. It is important that multiple stakeholder groups submit comments both on the *Voluntary* Best Practices and if and when the IRS asks for comments on foreign grantmaking. The Council on Foundations Treasury Guidelines Task Force, the ABA Tax Section Exempt Organizations Committee International Philanthropy SubCommitee, InterAction, Independent Sector, and the AICPA EO Committee are all likely candidates to submit comments. In addition, these groups are all likely to be working on one or more alternate documents containing practical approaches. Among the more significant problems with the current Treasury guidelines that should not be left unaddressed are the following:

1. Even large, well-staffed organizations are unlikely to have the capacity effectively to analyze information on such topics as overseas banking relationships and board members' organizational affiliations, even if they could obtain this information. Similarly, many reputable FROs are forced to rely on foreign funds-transfer organizations that compare unfavorably against U.S. banks but are the only available local organizations.

2. Asking personal information about a foreign organization's directors or staff will likely be seen as an invasion of privacy more typical of CIA tactics than of humanitarian assistance. It can endanger the lives and good works of

humanitarian relief workers (and funders) to ask too much. In my experience, suspicions are best overcome and information is most likely to be known in "friends of" and direct-operation situations where the U.S. funder may even be paying to employ the non-U.S. persons and therefore have access to this information. I also know, however, that some cultures and some religions expect "charity" to be conducted quietly and anonymously, which makes the obtaining of information almost impossible outside of the "friends of" and direct-operation structure.

3. In my experience, most foreign organizations do not have governing documents parallel to those in the United States. Similarly, they do not likely keep minutes recording adoption of governance policies. Therefore, outside of Western Europe, parts of Asia, and some countries in Eastern Europe, it would be unlikely to find formal conflict-of-interest policies or practices analogous to those in the United States and sought for review by the authors of the guidelines. In many countries, being an official of an NGO is seen as a way for the official to bring honor and material gain to his friends and family. In such cultures, it is expected that such an official will, for example, award construction contracts first to his family and second to his village. The arguments he will make in favor of such arrangements are that these are the only people in his country whom he can trust, with whom he has working experience, and over whom he has clout so they will not or cannot deceive/cheat him. In addition, I am aware of situations where non-U.S. individuals were willing to forego grant funds rather than agree to conflict-of-interest provisions or resign from conflicted positions in order to accept a prestigious position with a U.S. organization (see comments of Alison Bernstein, Ford Foundation, at March 9, 2003 conference in Paris sponsored by the French-American Foundation). In summary, "best practices" may vary based on the realities of a particular culture and the level of trust built up between the individuals who work with the organizations. Too rigid adherence to U.S. practices may hinder the U.S. funders' ability to assist competent, but non-conforming, FROs.

G. *Reporting to the IRS and the Public.*

1. Form 1023 — Where an organization reports on Form 1023 that it will likely pay 30% or more of its grants to non-U.S. organizations or individuals, it should be asked to explain its plans and partners. In the past, Form 1023 has focused on the overseas partner in greatest detail when a "supporting organization" relationship exists. It would be appropriate to get some reasonable explanation of other relationships in advance of a determination letter, and well-planned organizations are already giving it or will easily be able to give it. Once the IRS has this, however, it will have to decide to what use it can be put. Further, in supporting-organization cases and in "friends of" cases, it

is useful for the IRS to confirm that paid or volunteer representatives of the foreign grantee will not control the board or staff of the U.S. organization. Ironically, close working relationships (if not control of) the FRO likely increases a U.S. charity's ability to obtain the information Treasury would like the U.S. charity to have. But Treasury rules have historically worked to keep a measure of separation between the two. The time has come for practitioners and organizations to reconsider what level of interrelationship and what different configurations are desirable in both international supporting organization and "friends of" relationships and to which organization a dual officer or director owes his or her primary fiduciary duty.

2. Form 990 — As stated in the ABA Form 990 comments, I do not think it unreasonable for the IRS to break the grant-recipients schedule into the U.S. and non-U.S. organizations portions, as this information is already required. The Form 990 does not seek information as to the use to which funds were put and that could be a possible additional requirement, one that, as a practical matter, would most likely to be of interest to journalists and the public.

Further, I note that U.S. Department of Commerce Bureau of Economic Analysis Form BE-40 (copy attached) already asks "religious, charitable, educational, and other nonprofit organizations" to report "all transfers to foreign residents and organizations." In my experience, this form is sent by the Commerce Department to clients only rarely and sporadically. It is a voluntary submission used to support U.S. balance-of-payments accounts. The Commerce Department requests quarterly reports from organizations remitting more than $1 million annually and annual reports from organizations remitting $25,000 or more, up to $1 million. I note this form because some data is obviously already being collected by the federal government on the very topics of concern. Who has been filing? What are they reporting? Are they making grants to individuals or only to organizations? Are religious organizations filing completed forms? We cannot know because the forms and data are nondisclosable by law. I also note that the form includes no Middle Eastern country other than Israel and Israel is listed under "Asia, Africa, and Pacific." Federal officials may wish to consider their experience with this form and whether a revised version could be mandated for churches and other funders not currently reporting on Form 990 or 990-PF and for individuals who are overseas donors.

Finally, it must be noted that U.S. charities whose officials have bad intentions are not likely to be deterred by any Form 990 voluntary disclosure changes.

H. *Consider Churches*. For the reasons discussed above, practical consideration should be given to whether religious organizations that do not file Form 990 could or should be required to file a substitute form in

the event that they transfer funds overseas. Given its ties to the faith-based community, however, this Administration may be unwilling to consider such steps.

I. *Distinguish between Tax-Law and Criminal-Law Supervision*. A central point in the diversion-of-assets cases is that charities officials likely intended to divert funds. Those intentional acts likely violated criminal laws, in additional to violating § 501(c)(3) limitations on uses to which charitable funds can be put. Given their belief that divine law is above man-made law, these individuals would likely not follow voluntary reporting rules that could hinder their activities. Instead, it would appear that reporting of transfers might only be caught or reported by third parties (such as banks) which already have mandatory reporting obligations. Again, the advice of law-enforcement experts, the practical knowledge of legitimate charities, and the realities of the very limited resources available to police charities must all be considered in determining what law-enforcement, voluntary reporting, and mandatory reporting changes are most likely to dissuade charities officials from causing or permitting intentional diversions as well as failing to follow up on other diversions of which they become aware.

These are just a few of the questions we face going forward in our global society, and I predict that they will keep us occupied for several years to come.

Attachment 1

New Treasury Guidelines on Terrorist Funding Draw Criticism

By J. Christine Harris – christineh@tax.org

According to some exempt organization repre-sentatives, Treasury's recently released voluntary best-practices guidelines designed to help U.S.-based charities avoid terrorist financing are impractical and could increase charities' costs of performing due diligence.

Included in the guidelines' list of "voluntary best practices" are recommendations for developing and disclosing an "adequate governing structure," and procedures for evaluating and reviewing foreign recipient organizations (FROs) and their financial operations.

Not only should a charity's board of directors "be an independent governing body exercising effective and independent oversight of the charity's operations," but it should also meet at least three times annually, the guidelines advise. The board should also maintain public records of all its decisions.

Concerning charities' interactions with FROs, the guidelines suggest that charities collect the following types of information before distributing funds:

- the FRO's name in English, in the language of origin, and any acronym or other names used to identify the FRO;
- the FRO' principal purpose, including a detailed report of the organization's projects and goals;
- names and addresses of organizations to which the FRO "provides or proposes to provide funding, services, or material support, to the extent known, as applicable";
- names and addresses of any subcontracting organizations that the FRO uses;
- copies of any of the FRO's public filings or releases, "including most recent official registry documents, annual reports, and annual filing with the pertinent government, as applicable"; and
- the FRO's existing sources of income.

Treasury recommends charities also do some "basic vetting" of potential FROs. According to the guidelines, the procedures for the examinations should demonstrate that (1) the charity "conducted a reasonable search of public information, including information available via the Internet, to determine whether the [FRO] is or has been implicated in any questionable activity"; and (2) the charity "verified that the [FRO] does not appear on any list of the U.S. government, the United Nations, or the European Union identifying it as having links to terrorism or money laundering." Treasury also suggests that charities require that FROs certify that they are not linked to any entities or individuals on the U.S., Un, or EU lists.

Treasury's final recommendation is that charities review the financial operations of FROs and ask for bank references and periodic statements so that the charity can identify and track the financial institutions with which an FRO maintains accounts and the FRO's operational activities and use of disbursed funds. Treasury says that, depending on the size of the charitable disbursement, charities also should conduct routine on-site audits of FROs.

Treasury says that depending on the size of the charitable disbursement, charities also should conduct routine on-site audits of foreign recipient organizations.

According to Marcus S. Owens of Caplin & Drysdale, Washington, formerly the director of the IRS Exempt Organizations Division, the guidelines are useful in providing direction on how charities can minimize the risk of "the Treasury Department blocking actions." However, the guidelines "extend beyond aspects of charitable operations that are necessarily connected to grantmaking, such as public disclosure of board decisions, and have the potential to significantly raise the cost of due diligence" for charities that try to follow the guidelines while making foreign grants, he told Tax Analysts.

"For charities, including private foundations, making grants to foreign organizations and individuals, the relationship between the guidelines and federal tax law is ambiguous," Owens said. Although Treasury labeled the guidelines as "voluntary best practices guidelines," they have been issued by the same agency that is charged with issuing rules and regulations for interpreting the Internal Revenue Code, he observed, noting that Treasury and the IRS have set forth "very vague standards for oversight of foreign grants by public charities (Rev. Rul. 66-79 [regarding] the charity exercising 'control and discretion' over the use of its grant funds); and more detailed regulations under section 4945 concerning expenditure responsibility by private foundations." He said reg. section 53.4945-5(b)(2)(ii), Example 1, describes an appropriate pre-grant inquiry as including a check of police records in appropriate circumstances.

Owens said the Treasury news release accompanying the guidelines doesn't make clear how best practices for due diligence in foreign grantmaking under the rules set by Treasury's Office of Foreign Assets Control (OFAC) interact, if at all, with the tax law standards of "control and discretion" for public charities and "all reasonable efforts" under section 4945 for private foundations. "The $64,000 questions are whether Treasury interpretations will be consistent across the board and how the donating public will view the board and how the donating public will view a charity that does not publicly adopt the guidelines," he said.

Nancy Ortmeyer Kuhn and Michael I. Sanders of Powell, Goldstein, Frazer & Murphy, Washington, called the record-keeping requirements "onerous" for "the vast majority of charities [that in Kuhn and Sanders's experience] would not knowingly contribute money to a terrorist organization." Some of Treasury's suggestions, which are similar to the documentation required of private foundations when satisfying the expenditure responsibility requirements of section 4945, are "good in theory but too onerous, to a public charity, to be practical," they said, noting that "the section 4945 requirements have been criticized as onerous for private foundations. These voluntary requirements for public charities are even more onerous," making it doubtful that public charities would be able to comply with all of the suggested actions, they said.

'For charities, including private foundations, making grants to foreign organizations and individuals, the relationship between the guidelines and federal tax law is ambiguous,' Owens said.

Kuhn and Sanders also criticized the guidelines' reference to government lists of questionable entities and individuals. The guidelines encourage charities to check several lists of terrorist organizations, but they don't say where the charities might access the lists, they said. "In this era of the Internet, it would greatly assist charities if they could consult current lists of terrorist organizations via the Internet," they said.

Kuhn and Sanders said a search of the referenced government agencies' Web sites yielded only one of the lists online: OFAC's list of specially designed nationals, which is available on the agency's Web site at http://www.treas.gov/offices/enforcement/ofac/sdn/t11sdn.pdf. Searches of Web sites for the Justice Department, the UN, and the EU yielded no sign of a "terrorist exclusion list."

Kuhn and Sanders also observed that many of the "voluntary" guidelines are "anything but voluntary." Guideline such as the one recommending governing instruments and a community board of directors are requirements for recognition as a public charity under section 501(c)(3) and the accompanying Treasury regulations, they said. Other best-practices guidelines, relating to public documentation of the board of directors and the financial status of the charity (required to appear on the charity's Form 990) and information on the charity's goals and purposes (required by the organization's Form 1023 application for exempt status), are public disclosures required by statute and are not voluntary, according to Kuhn and Sanders. "It is misleading for the Treasury publication to list [those] actions as voluntary," they said.

Victoria Bjorklund, Thacher, Simpson, and Bartlett, New York also expressed concern about the capacity of the typical U.S. funder to comply with the guidelines. "It might require the skills of Treasury, OFAC, and the CIA to ascertain whether a foreign donee uses a 'shell' bank," and "even if the cautious funder contractually requires the donee to use a legitimate bank, the next gift down the chain can be the diverted gift," she said.

Bjorklund said she "applaud[s] such reasonable guidelines as: knowing your grantee organization, performing periodic site visits, and following up by obtaining reports on the charitable use of donated funds," but said she believes

the "truly devious" will not be thwarted if a U.S. funder attempts to follow all of these guidelines."

Charities do not have the training, resources, or police power necessary to conduct effective money-laundering investigations, Bjorklund said. If they become intimidated by the guidelines, there may be a push toward more funding of U.S.-based charities operating abroad than funding or indigenous nongovernmental organizations operating in those countries, she added. ■

Full Text Citations: Treasury's *Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities. Doc 2002-25472 (7 original pages); 2002 TNT 221-17*

Attachment 2: Commerce Dept. Bureau of Economic Analysis Form BE-40.