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June 20, 2003

David Aufhauser
General Counsel
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Re: U.S. Department of the Treasury Anti-Terrorist Financing Guidelines: *Voluntary* Best Practices For U.S.-Based Charities.

Dear Mr. Aufhauser:

On behalf of the Council on Foundations, I am enclosing comments on the U.S. Department of the Treasury Anti-Terrorist Financing Guidelines: *Voluntary* Best Practices For U.S.-Based Charities.

The Council's membership is composed of more than 2,000 private foundations, public charities, and corporate grantmakers. These comments are the product of the work of a task force of Council members that included private foundations, corporate grantmakers, and public charities with significant experience in international grantmaking. We believe the comments reflect the practical realities those organizations face as they try to implement the Guidelines. Still, given the breadth of the field, the Council's comments cannot possibly represent the perspectives of all international grantmaking organizations. We urge the Treasury Department to carefully consider all comments offered in response to the Guidelines, whether submitted by umbrella groups such as the Council or by individual grantmaking organizations.

The Council of Foundations shares the Treasury Department's goal of preventing the diversion of charitable funds to terrorist uses and would welcome an opportunity to discuss the attached comments, which we believe offer an effective alternative to the current version of the Guidelines.

Sincerely,

Dorothy S. Ridings
President and Chief Executive Officer

Enclosure

cc: Juan Zurate, Deputy Assistant Secretary for Terrorist Financing and Financial Crimes

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Comments on
U.S. Department of the Treasury Anti-Terrorist Financing Guidelines: Voluntary Best Practices For U.S.-Based Charities

June 20, 2003

EXECUTIVE SUMMARY

The Council on Foundations welcomes the opportunity to comment on the Treasury Department's "Antiterrorist Financing Guidelines: *Voluntary* Best Practices for U.S.-Based Charities," released in November 2002. The stated objective of the Treasury Department -- to guard charitable funds from diversion to terrorist organizations without "chilling legitimate good works" -- is one we share. However, the Guidelines fail to accomplish this objective by adopting a "one size fits all" approach that would greatly increase the administrative cost of making all international grants, without helping U.S. charities identify and take appropriate precautions with respect to the very small number that are at risk for diversion. The unintended consequence would be to jeopardize a vast amount of "legitimate good works" by discouraging the making of all international grants, including (but by no means limited to) those in developing countries where the needs for humanitarian assistance are at unprecedented levels. Given the important issue that the Guidelines seek to address -- and the equally important role of the charitable sector in addressing critical international needs, we request that the Treasury Department withdraw the Guidelines and reissue them after an opportunity to consider these and other comments.

Our comments are straightforward. We believe that the objective of the Guidelines can best be achieved by helping U.S. charities develop and apply a risk-based approach that (1) helps the grantmaker to identify those grants that may present a greater risk for diversion, and (2) describes additional steps that the grantmaker may take to minimize the possibility of diversion for grants that are so identified. This two-step risk assessment process, which would replace the factors currently set forth in Section IV of the Guidelines, strikes an appropriate balance between the need to protect charitable funds from terrorist diversion and the equally important need to allow U.S. charities to continue providing humanitarian relief and helping to build free and democratic societies in chaotic nations that have been devastated by war, famine, disease and internal turmoil.

The Council also recognizes that governance, accountability and transparency are hallmarks of responsible philanthropy. Contrary to the approach taken in the Guidelines, however, there is no single set of "best practices" in these areas. Moreover, some of the "best practices" listed in the Guidelines are internally inconsistent and/or contrary to federal and state laws governing charities. Accordingly, the Council recommends that the list of "best practices" set forth in Sections I, II and III of the Guidelines be replaced by a list of general principles of governance and financial accountability that would be considered relevant in an investigation by the Treasury Department of the alleged use of funds to support terrorism.

Finally, the Council recommends that the title of the Guidelines and the preamble be revised to reflect the important legal context for the document: implementation of the USA Patriot Act of 2001 and Executive Order No. 13224. These revisions will make it clear that, although the Guidelines are denominated as voluntary, a charity's good faith compliance with them will help reduce the likelihood of a blocking order against the organization or its donors in the event of an investigation concerning the alleged diversion of funds to support terrorism (provided, of course, that there is no knowledge or intent to use funds for that purpose).

I. Introduction

We appreciate the opportunity to comment on the voluntary guidelines issued by the Treasury Department entitled: "Anti-Terrorist Financing Guidelines: *Voluntary* Best Practices For U.S.-Based Charities" (the "Guidelines").

We share the Treasury Department's concern that grants made by U.S. charitable organizations not be used to finance terrorism. While the programs funded by grantmakers have widely diverse objectives, there is one common ground -- they are all directed exclusively to serving the public good. We are mindful that Executive Order 13224 and other applicable laws prohibit the provision of financial, material or technological support for acts of terrorism. Although only a very small number of international grants might be susceptible to diversion for terrorist purposes, any such use of funds would be antithetical to our charitable mission as well as U.S. law, and we are committed to minimizing the risk that this might occur. The Guidelines issued by the Treasury Department have helped alert grantmakers to the importance of this matter.

We also support the Administration's goal of strengthening the charitable sector. Government alone cannot solve every problem, and charitable organizations independently contribute creative solutions. Indeed, the overseas efforts of U.S. grantmakers augment the government's war on terrorism by providing humanitarian relief and helping to build free and democratic societies in chaotic nations that have been devastated by war, famine, disease, and internal turmoil. Grantmakers provide educational and economic opportunities, reduce poverty and suffering, and foster appreciation for the United States and its democratic values.

We believe it is important that the Guidelines reflect both of these objectives--reducing the risk that international grants will be used to support terrorism while supporting the efforts of charitable organizations to address the need for global assistance. In order to achieve this balance, we agree with the Financial Action Task Force on Money Laundering that "[g]overnment oversight should be flexible, effective, and proportional to the risk of abuse."[1]

As written, the Guidelines do not accomplish these objectives for several reasons. They are not tailored to the reality of international grantmaking by U.S. charitable organizations. They do not take into account either the legal requirements governing international grants or the extensive experience of U.S. grantmakers in administering foreign grant funds. And they include provisions that are simply unworkable in many respects, are wholly unrelated to achieving the intended objectives, and have a compliance cost so high as to deter many charitable organizations from making international grants. Accordingly, we request that the Treasury Department withdraw the Guidelines and reissue them after an opportunity to consider the following and other comments.

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[1] Financial Action Task Force on Money Laundering, "Combating the Abuse of Non-Profit Organizations, International Best Practices," October 11, 2002, p. 2.

The comments set forth below represent the views of a task force of members of the Council on Foundations and their representatives.[2] These comments are intended to assist the Treasury Department in developing revised Guidelines that will accomplish the goal of minimizing the risk that international grants might be used to support terrorism, while at the same time fostering international grantmaking, including that which helps ameliorate the conditions that support terrorist activities. In addition to providing humanitarian assistance to countries ravaged by war and terrorism, U.S. grantmakers and other nonprofit organizations contribute to promoting the rule of law and institutions of democratic governance; encouraging civil discourse and conflict resolution; expanding economic opportunity, education, and health programs; and promoting better understanding between the United States and other countries and societies. These programs are funded not only by charitable organizations but also by private citizens and corporations, as well as by the Congress, the U.S. Department of State, and the United States Agency for International Development, and other parts of the U.S. government.

To that end, these comments begin with an overview of trends in international grantmaking by U.S. charitable organizations, followed by a brief discussion of current legal standards applicable to U.S. grantmakers. This overview provides important context for our specific comments on the Guidelines, including recommendations as to how our shared objectives may better be achieved.

II. Overview of International Grantmaking

The Treasury Department's stated goal for the charitable sector in the financial war on terrorism "is to guard charities against abuse without chilling legitimate good works."[3] This is an important goal, and one we share.

The abuse of charitable funds is a serious concern to the charitable community. Accusations against the Afghan Support Committee, the Revival of Islamic Heritage Society, Holy Land Foundation and others are disturbing. We recognize that the charitable community has an obligation to work to prevent the diversion of charitable dollars to the support of terrorist activities. We also recognize, however, that the misuse of U.S. charitable funds is by no means the principal source of financing for terrorist activities. The largest source of funds for terrorist activities comes from other sectors, including "websites, intermediaries, facilitators, and banks and other financial institutions,"[4] as well as the estimated $150 billion in remittances transacted by expatriates in a typical year.[5]

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[2] We understand that a number of smaller organizations, many of whom are not members of the Council, believe that the standards described in the Guidelines would disproportionately impact their ability to conduct operations abroad or make grants to foreign organizations. We understand that these organizations will also submit comments on the Guidelines.

[3] "Contributions by the Department of Treasury to the Financial War on Terrorism, Fact Sheet," U.S. Treasury Department, September 2002, at 12.

[4] "Terrorist Financing, Report of an Independent Task Force Sponsored by the Council on Foreign Relations," Council on Foreign Relations, 2002.
(continued)

Furthermore, the very small number of charities where funds have been frozen represents but a tiny fraction of the larger international grantmaking community. In 2001, international grantmaking by U.S. private foundations and corporate donors totaled $2.46 billion.[6] U.S. public charities contributed some $1.6 billion as well, for a combined total of more than $4 billion.[7] The "legitimate good works" being accomplished with this funding are vast in comparison with the diversions for terrorist financing.

While it is unacceptable for any amount of charitable funds to be sent overseas for terrorist purposes, we think these numbers are important considerations in fashioning an appropriate response. Consequently, as the Treasury Department considers how to stop abuse of charitable funds without chilling legitimate good works, we feel it is important to provide a broader perspective on the U.S. international grantmaking community.

A. Trends in International Grantmaking

Foreign grantmaking by U.S. charitable organizations is on the rise both in terms of dollar value and in terms of the proportion of all grants made by U.S. organizations. As noted above, U.S. private foundations and corporate donors made over $2.46 billion in grants overseas in 2001, representing an increase of $1.5 billion in less than a decade. In addition, foreign grants constituted 16.3 percent of grant dollars given in 2000 by U.S. foundations and corporate donors, up from just 5 percent in 1982.[8]

In terms of geography, most U.S. international grant funding goes to organizations in England, which receive nearly 12 percent of all funds from U.S. foundations and corporations. Another 25 percent of U.S. funding goes to organizations located in South Africa, Canada, Mexico and Brazil.[9] Regionally, grant funding breaks down as follows: Western Europe, 22 percent; Latin America, 21.6 percent; Asia and the Pacific, 18.9 percent; Sub-Saharan Africa, 18.7 percent; Eastern Europe, Russia and the Independent States, 6.4 percent; Canada, 5.7 percent; North Africa & the Middle East, 5.6 percent; and the Caribbean, 1.1 percent.[10]

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5 "Global Money Transfers: Exploring the Remittance Gold Mine," Celent, 2002.

6 "Foundation Giving Trends," The Foundation Center, 2003.

7 The AAFRC Trust for Philanthropy estimates that giving to international, foreign affairs, and national security organizations totaled $4.14 billion in 2001. This includes grants for culture exchanges, aid to international students, economic and agricultural development in other countries, disaster relief abroad, promotion of international peace or security, or advancement of human rights in other countries. Giving USA 2002, The Annual Report on Philanthropy for the Year 2001, AAFRC Trust for Philanthropy, 2002.

8 Figures include giving domestically for international programs as well as giving abroad. "Foundation Giving Trends," The Foundation Center, 2003 Edition and 2002 Edition: "International Grantmaking II, An Update on U.S. Foundation Trends," The Foundation Center in cooperation with the Council on Foundations, 2000.

9 Id., at 54.

10 Id., at 52.

These funds are distributed across many program areas. In 1998, 17.5 percent of international grant funding was directed toward international development, 14.8 percent toward health programs, 13 percent to international affairs, 10.9 percent to education, 9.9 percent to social sciences, 8.6 percent to the arts, 8.4 percent to the environment, 7.8 percent to human rights, 4.9 percent to public/society benefit, 2.7 percent to religion, and 1.5 percent to science.[11]

In the context of this letter, it is not possible to convey fully the range of U.S. foreign grantmaking institutions. Organizations of all sizes and budgets make foreign grants. Some private foundations make large, long-term funding commitments to foreign organizations; they and others also make much smaller grants to a variety of indigenous organizations. Corporate foundations may make larger grants, as well as smaller employee matching contributions. Others are U.S.-based charities that have special ties to particular overseas organizations (such as foreign institutions of higher education), or that make gifts to foreign charities through donor-advised funds. Still others are U.S. public charities that support overseas charitable efforts through direct aid or humanitarian activities. Even among private foundations, which are likely to make the largest overseas grants, half of the grants made in 1998 were of less than $41,500.[12]

Under applicable federal tax laws, small grants require as much due diligence as large grants, but many organizations nevertheless continue to make small grants to address needs in extremely poor regions of the world, where it is critical to scale the grant size to the economy and capacity of the grantee. Thus, while $41,500 might be the median grant size for private foundations, grants of even $500 are not uncommon when grantmakers judge these amounts most effective to serve particular charitable purposes.

The Guidelines would be more effective in stemming the flow of funds to terrorist purposes while safeguarding charitable giving if they acknowledged the diversity of the U.S. international grantmaking community. Under such a "risk-based approach to the problem,"[13] resources could be dedicated to those grants that pose the greatest risk of diversion to terrorist purposes and costs of compliance with the Guidelines would not exceed the value of the grant.[14]

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11 Id., at 62.

12 Id., at 25.

13 Financial Action Task Force on Money Laundering, "Combating the Abuse of Non-Profit Organizations, International Best Practices," October 11, 2002, pp. 1.

14 According to the Financial Action Task Force on Money Laundering, "Mechanisms that reduce the compliance burden without creating loopholes for terrorist financiers should be given due consideration. Small organizations that do not raise significant amounts of money from public sources, and locally based associations and organizations whose primary function is to redistribute resources among members may not necessarily require enhanced government oversight." Financial Action Task Force on Money Laundering, "Combating the Abuse of Non-Profit Organizations, International Best Practices," October 11, 2002, pp. 1, 2.

B. International Grantmaking to Support the Building of Free and Democratic Societies

While the vast majority of international grantmaking is directed at recipients and in regions that pose little or no threat of diversion of funds for terrorist purposes, the work done in areas of the world where terrorism is a problem remains crucial in promoting values that are consistent with the building of free and democratic societies. As the Council on Foreign Relations has observed, "those committed to democracy should assist those struggling to establish democracy in countries that have not chosen the democratic path. The first steps on the path are neither quick nor easy . . . "[15]

The U.S. government, even with the post-September 11 awareness that U.S. funds could be diverted to terrorist uses, has affirmed the value of sending funds abroad. In March, 2002, President Bush explained the U.S. commitment to increase assistance to developing countries by 50 percent over the next three years as follows:

> History has called us to a titanic struggle, whose stakes could not be higher because we're fighting for freedom, itself. We're pursuing great and worthy goals to make the world safer, and as we do, to make it better. We will challenge the poverty and hopelessness and lack of education and failed governments that too often allow conditions that terrorists can seize and try to turn to their advantage.[16]

U.S. grantmakers have been working to challenge these conditions overseas for many years. With the sweeping geopolitical changes and the rise of emerging democracies and free markets in the early 1990s, grantmakers began to place a greater emphasis on development, health, education, human rights and civil liberties, and arms control and conflict resolution. By the late 1990s, funding doubled in the areas of human rights, civil liberties and public and society benefit (which includes grants for public affairs, philanthropy, and promotion of a free and democratic society).[17] In the best of times, international grantmaking is a targeted, creative and dynamic complement to U.S. foreign aid. In other circumstances, international grantmaking might be a critical gap-filler, such as in the current climate when the U.S. government has redirected funds intended for humanitarian crises worldwide to address the aftermath of the conflict in Iraq.[18]

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15 "Threats to Democracy: Prevention and Response, Report of an Independent Task Force Sponsored by the Council on Foreign Relations," Council on Foreign Relations, 2002, at 15.

16 "President Outlines U.S. Plan to Help World's Poor," Remarks by the President at United Nations Financing for Development Conference, Cintermex Convention Center, Monterrey, Mexico, March 22, 2002.

17 "International Grantmaking II, at 61.

18 Roger Thurow and David Bank, "U.S. Diverts Relief Funds To Prepare for Iraq Needs," Wall Street Journal, April 11, 2003, p. A8.

C. Legal Requirements for International Grants

All members of the U.S. international grantmaking community must abide by special federal tax rules applicable to foreign grants.[19] The rules, which differ depending upon whether the grantmaker is a private foundation or a public charity, restrict the purposes for which grants can be made to charitable purposes and then require reporting to verify that the grant dollars are actually used for the intended purposes.[20]

Private foundations may demonstrate that a grant to a foreign organization will be used for the charitable purposes for which it was given in one of two ways. The first, equivalency determination, is an abbreviated version of the process by which organizations apply to the IRS for recognition as a public charity, and it focuses on the qualities of the organization that safeguard the charitable use of the grant.[21] The second, expenditure responsibility, focuses specifically on why a particular grantee is well suited to carry out the terms of a particular grant, and then monitors the grantee's progress in doing so.[22]

Equivalency determination requires a private foundation to obtain sufficient information from the grantee so that the foundation or its counsel can make a reasonable determination that the grantee would qualify for IRS recognition as a charity under section 501(c)(3) and as a public charity under section 509(a). The grantee will generally need to provide the following information:

- A detailed description of its purposes and activities;
- Copies of its charter, bylaws and/or other governing documents;
- Evidence that under the governing laws or documents:
    - no inurement or improper private benefit is permitted from the grantee's income or assets;
    - upon dissolution, assets will be distributed to another charitable organization; and
    - the grantee is not permitted to engage in activities, other than as an insubstantial part of all activities, that are not for charitable purposes or that attempt to influence legislation; and

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19 Churches, temples, and mosques are not required to file Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, nor are they required to file Form 990, Return of Organization Exempt from Income Tax. Accordingly, these organizations' foreign grantmaking activities are not as easily monitored as those of public charities and private foundations.

20 If, however, a foreign grantee has obtained IRS recognition that it qualifies as a public charity described in section 509(a) of the Internal Revenue Code, the grantmaker can rely on the Service's ruling and make the grant without undertaking any more investigation than would be required to make a grant to a public charity based in the United States. Few foreign organizations, however, have applied for IRS recognition of their public charity status.

21 See Treas. Reg. 53.4945-6(c)(2)(ii).

22 See I.R.C. Sec. 4945(h).

- A financial statement for the last four taxable years showing sources of public support, unless the organization qualifies as a school, a hospital, or a church.[23]

A grantor may opt to exercise expenditure responsibility instead of making a public charity equivalency determination for any number of reasons. In some cases, an equivalency determination will not be possible. A new organization, for example, would not be able to submit four years of financial support to qualify as the equivalent of a public charity under the procedures detailed by the Service for foreign equivalence.

Expenditure responsibility requires that the foundation take the following five steps with respect to its grant:

- Make a reasonable inquiry to determine whether the grantee can be relied upon to fulfill the charitable purposes of the grant;
- Enter into a written grant agreement that restricts the funds to approved purposes and prohibits use for any non-charitable activities;
- Obtain annual reports on the use of the grant funds and what has been accomplished toward achieving the purposes of the grant;
- Correct any diversion of the grant funds that the foundation learns of; and
- Report the grant as an expenditure responsibility grant and provide certain other information on the foundation's annual information return filed with the IRS, Form 990-PF.

A U.S. public charity may make grants to foreign organizations, under the federal tax rules, provided it "retains control and discretion as to the use of the funds and maintains records establishing that the funds were used for section 501(c)(3) purposes."[24] Furthermore, in order to assure the deductibility of charitable contributions made to support projects of foreign charities, the tax laws require the U.S. charity to conduct its own review of the projects in advance to determine that they would further its exempt purposes, in addition to retaining control and discretion over the use of donated funds.[25] While these rules are less detailed than the rules for private foundations, many public charities undertake some version of the expenditure responsibility process described above, including a pre-grant inquiry, a written agreement signed by the grantee specifying that the grant will be used only for charitable purposes, and annual progress reports until the grant has been expended as an exercise of reasonable and prudent grant or project management.

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23 Under Rev. Proc. 92-94, 1992-2 CB 507, a grantee can provide this information in the form of an affidavit to a grantor to enable the grantor to make a reasonable determination that the grantee is the equivalent of a U.S. public charity.

24 Rev. Rul. 68-489, 1968-2 CB 210.

25 Rev. Rul 66-79, 1966-1 CB 48.

III. Comments on the Guidelines

With the overview set forth above as context, we have the following specific comments on the Voluntary Guidelines.

A. Title

Our concerns with the Voluntary Guidelines begin with the title: "U.S. Department of the Treasury Anti-Terrorist Financing Guidelines: *Voluntary* Best Practices for U.S. Based Charities." The use of the term "best practices" is misleading and suggests that the Guidelines have a purpose far broader than what we believe is intended or appropriate. There is no consensus within the charitable sector as to what constitutes "best practices." Indeed, lists of "best practices" (or similar guidelines) issued by nonprofit watchdog groups, some of which the Treasury Department examined in developing the Guidelines, differ from each other on many of their specific recommendations.[26]

Furthermore, by including the term "best practices" in the title, the unavoidable implication is that organizations that do not comply with all of the provisions of the Guidelines are not following "best practices." Coming from an agency with regulatory authority over tax-exempt organizations, this is very troubling to many grantmakers, who rightly question that implication.

Whether the practices listed in the Guidelines are "best practices," or simply "good practices," or even "recommended practices" is not relevant to the purpose of the Guidelines – which is to promote compliance with anti-terrorist financing laws. In order to focus attention on the matter at hand, we recommend that the "best practices" phrase be deleted and the title be renamed to reflect the intended purpose, such as "U.S. Department of the Treasury Voluntary Guidelines for Implementing Anti-Terrorist Financing Laws by U.S.-Based Charities."

B. Preamble to the Guidelines

The preamble to the Guidelines is quite brief and states simply that:

> Compliance with these guidelines should not be construed to preclude any criminal or civil sanctions by the Department of the Treasury or the Department of Justice against persons who provide material, financial, or technological support or resources to, or engage in prohibited transactions with, persons designated pursuant to the Antiterrorism and Effective Death Penalty Act of 1986, as amended, or the International Emergency Powers act, as amended.

The preamble, as written, is in the nature of a caveat – a warning that compliance with the Guidelines will not preclude the possibility of civil or criminal enforcement action by the

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[26] See, e.g., BBB Wise Giving Alliance, "Standards for Charitable Accountability;" Evangelical Council for Financial Accountability, "Standards of Responsible Stewardship for Members;" and Council on Foundations, "Principles and Practices for Effective Grantmaking."

Treasury Department or the Department of Justice. We understand the need for such a caveat, but standing alone, it is insufficient to alert grantmakers to the broader legal context leading to issuance of the Guidelines. In order to accomplish this, we believe that the preamble should explain that Executive Order No. 13224 and the USA Patriot Act of 2001 (the "Patriot Act") prohibit providing financial support for acts of terrorism or to individuals and organizations identified by the U.S. government as associated with terrorism, increase the penalties for engaging in such transactions, and give the Secretary of the Treasury authority to block the property of organizations that are considered to have funded acts of terrorism or individuals or organizations identified by the U.S. government as foreign terrorist organizations.

We also recommend that the preamble be revised to explain the purpose of the Guidelines. According to Press Release PO-3607 (announcing the issuance of the Guidelines), the Guidelines are "intended to reduce the likelihood that charitable funds will be diverted for violent ends." The Press Release goes on to state that if "a U.S.-based charity follows these guidelines, and commits resources to implement them effectively, there will be a corresponding reduction in the likelihood of a blocking order against any such charity or donors who contribute to such charity in good faith, absent knowledge or intent" to support terrorist organizations. Consistent with these statements, the preamble should provide that the purpose of the Guidelines is to provide guidance to grantmakers about voluntary steps they can take to reduce the risk that grant funds might be used to support terrorism, and consequently that they might be subjected to a blocking order.

We believe that the preamble should state explicitly that there will be no negative inference from an organization's failure to comply with any particular provision of the Guidelines.[27] Unless this is done, we are concerned that the Guidelines might be interpreted as setting forth the only factors that would be relevant in determining whether an organization has taken reasonable steps to ensure that it is not supporting terrorist activities. It is consistent with the voluntary nature of the Guidelines that no per se conclusion be drawn from failure to comply, and that organizations should, if the need arises, be able to point to other actions they have taken to prevent the use of grant funds to support terrorism. Indeed, given the diverse purposes and types of international grants, the approaches to oversight may vary significantly depending on particular facts and circumstances.

Finally, as we have discussed above, charitable organizations are subject to specific federal tax laws, regulations and rules governing the making of international grants. These requirements are separate from the provisions of the Guidelines. We believe it is important to state explicitly in the preamble that the Guidelines do not supplement, modify or supersede applicable federal tax

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[27] As discussed below, we acknowledge that it is the responsibility of grantmaking organizations to check potential foreign grantees against official lists. For organizations to do so, however, it is essential that the Treasury Department provide specific guidance as to what lists need to be checked and where they may be found. See footnote 30 and accompanying text.

law and are not intended to demarcate legally prudent behavior as that concept is incorporated in applicable state corporate and federal tax laws.[28]

C. Sections I, II and III

Sections I, II and III of the Guidelines are entitled "Governance," "Disclosure/Transparency in Governance and Finances," and "Financial Practice/Accountability." Each of these sections contains a number of specific "dos and don'ts" that appear to be derived, at least in part, from publications developed by various nonprofit watchdog groups.

As a threshold matter, we recognize that these three topics -- good governance, disclosure and transparency, and financial accountability -- are hallmarks of responsible philanthropy. We agree that it would be appropriate for the Treasury Department to look into an organization's general practices in these areas in deciding what type of enforcement action to take with respect to a charitable organization or donor that is under investigation for allegedly funding terrorism. At the same time, as we have noted above, there is simply no single set of "best practices," and the effort to identify such standards in the context of the Guidelines has raised serious concerns among grantmakers.

Sections I.B.2.a and b present a clear example of the problems raised by the Guidelines. The two provisions are internally inconsistent. The former provision states that an organization should have a conflict of interest policy governing the procedures to be followed in the event of a conflict, and the latter states that the organization should not engage in any transactions with entities in which a board member has a conflict of interest -- presumably not even if the conflict of interest policy is followed. The latter, more restrictive provision goes well beyond the standards contained in most state nonprofit corporation and charitable trust statutes, which expressly permit organizations to engage in transactions with interested directors or trustees where such transactions are at fair value. We assume, of course, that the Guidelines are not intended to supersede state laws on this issue.

Moreover, federal tax laws applicable to public charities (and to private foundations in some cases) also expressly permit transactions with interested directors or trustees as long as they are at fair value.[29] Indeed, many organizations are economically benefited by engaging in

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[28] The Internal Revenue Service, in Announcement 2003-29, has requested public comment on how it might modify tax rules to "reduce the possibility of diversion of assets for non-charitable purposes while preserving the important role of charitable organizations worldwide." The Service notes that it is considering guidance that would apply to both public charities and private foundations with respect to international grantmaking and activities. As the IRS notes, the "guidelines were developed to help a charity reduce the risk that the charity's funds would be frozen in connection with any ongoing anti-terrorism investigation," while current tax rules have "focused more on reducing the risk that charitable assets might be diverted for personal gain." The IRS is considering how to expand the tax rules to ensure that funds are not diverted for non-charitable purposes other than personal gain, including terrorist activities.

[29] Although private foundations are subject to strict rules against self-dealing under Section 4941 of the Internal Revenue Code, foundations may engage in certain transactions with directors, including paying reasonable (continued)

transactions with interested directors who provide essential goods or services on a below market basis in order to support the work of the organization. More to the point, whether or not an organization engages in transactions with interested directors or trustees is unlikely to have any impact on preventing the use of grant funds to support terrorism.

Other provisions of these Sections are unnecessary because they describe a number of actions that are in fact required of most grantmakers under applicable provisions of the federal tax laws. This is a source of potential confusion because although the Guidelines are denominated as "voluntary," compliance with the federal tax laws is mandatory for charitable organizations. Provisions in this category include those seeking disclosure of the names and compensation of directors and five highest paid employees and the identity of subsidiaries and affiliates and those requesting organizations to make financial information available to the public upon request. All these disclosure requirements are contained in IRS Form 990, Return of Organization Exempt from Income Tax, and Form 990-PF, Return of Private Foundation, which are required to be filed with the IRS -- and made available to the public upon request -- by all Section 501(c)(3) organizations except churches and very small organizations (those with annual gross receipts that are normally less than $25,000).[30] Including these provisions in the Guidelines is thus largely redundant with federal tax law requirements. Moreover, as with the conflict of interest provisions discussed above, we believe these disclosure provisions are unlikely to have any impact on preventing the use of funds to support terrorism.

The above are just a few examples of the issues raised by the provisions included in Sections I, II and III of the Guidelines. In our view, the specific provisions set forth in these Sections are unnecessarily detailed and restrictive, and are unlikely to be more effective than general good operating practices in preventing the use of funds to support terrorism. What we recommend, instead, is that Sections I, II and III be combined into a single section entitled "Governance and Accountability" which lists the general principles applicable to organizational governance and financial accountability that would be considered relevant to the Treasury Department in the event of an investigation concerning the alleged use of funds to support terrorism. This should include principles such as the following:

- The charity should be governed by a board of directors (or by one or more trustees) that oversees the management of the organization in furtherance of its charitable purposes and maintains minutes or other records of its decisions.

- The charity should adopt procedures for accounting for all funds that are adequate to document the sources of funds and the uses of such funds in furtherance of the organization's charitable purposes.

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compensation for personal services, accepting an interest-free loan from a director as long as the proceeds are used for charitable purposes, and providing goods, services or facilities to a director on the same terms as such items are offered to the general public.

[30] As noted above, churches and other religious organizations are not required to file annual information returns with the IRS on their programs and expenses. Given the sensitive First Amendment issues involved, we doubt that the Guidelines are intended to serve as a vehicle to seek public disclosure of such information by these organizations.

- The charity should ensure that the board of directors (or trustees), officers and staff members are informed about the legal requirements affecting international grantmaking (including Executive Order 13224 and the Patriot Act).

- The charity should adopt internal anti-terrorist funding procedures appropriate to its own particular grantmaking program (including procedures such as those discussed below in our comments on Section IV).

- The charity should make disbursements by check or wire transfer rather than in cash whenever such financial arrangements are reasonably available. Where normal banking arrangements do not exist or other exigencies require the making of disbursements in cash (as in the case of humanitarian assistance provided in rural areas of many developing countries), the charity should disburse funds in smaller increments sufficient to meet immediate and short-term needs rather than in large sums intended to cover needs over an extended time frame, and should exercise oversight regarding the use of funds for the intended charitable purposes, including keeping detailed internal records of such cash disbursements.

By setting forth general principles along the lines of those outlined above, the Guidelines would accomplish the intended objective of alerting organizations to the need to have general governance and accountability procedures that will help prevent the use of funds to support terrorism, without entangling the Treasury Department in an unnecessary debate over whether the specifically enumerated provisions constitute "best practices" for grantmakers.

D. Section IV

Section IV of the Guidelines, denominated the "Anti-Terrorist Financing Procedures," focuses specifically on steps that grantmakers should follow before making grants to "foreign recipient organizations" ("FROs"). These steps include collecting a broad range of information about the FRO; conducting a basic vetting of the FRO, including checking to make sure it does not appear on certain government lists identifying parties with links to terrorism or money laundering; and reviewing the financial operations of the FRO.

As a threshold matter, we recognize the responsibility of grantmakers to undertake reasonable investigations of FROs to minimize the risk that grant funds will be used to support terrorism. We also know, from decades of experience providing humanitarian assistance in countries ravaged by war, disease, famine and internal conflict, that the work of grantmakers is critical to the rebuilding of a free and democratic society, which – in turn -- is essential in combating terrorism. Our comments on Section IV are informed not only by these decades of experience, but also by more recent experiences, post-9/11, in responding to humanitarian needs in countries and regions that have suffered from the existence of terrorism.

One important provision in Section IV of the Guidelines is intended to help grantmakers demonstrate compliance with Executive Order 13224 and the Patriot Act. This is the provision concerning the need to check the lists specifically discussed in the Executive Order prior to

making a grant to a potential FRO. We are concerned, however, that the provision as written (Section IV.B.2.) goes beyond the requirement of the Executive Order and is so broad and vaguely worded ("any list of the . . ." and "any other official list available to the charity") that compliance may be difficult, if not impossible. In order to enable grantmakers to identify the appropriate lists that should be checked, we strongly recommend that the Treasury Department either compile all the names on a single list that could be searched, or at a minimum identify and provide links to all relevant lists from one website.[31]

With respect to the other provisions listed in Section IV of the Guidelines, we have concerns about the practical ability of most grantmakers to comply, the unintended adverse consequences that might result from efforts to comply, the utility of compliance (where that is possible) in accomplishing the intended objective, and the cost of compliance. The discussion below summarizes these concerns in broad terms and proposes an alternative approach that we believe to be realistic for grantmakers and more effective in accomplishing the intended objective.

First, it is important to emphasize that most grantmakers, even large organizations with adequate resources and staff, are likely to have difficulty obtaining from FROs the detailed information recommended by the Guidelines, and are unlikely to be able to analyze such information effectively if they are able to obtain it. As examples:

- Section IV.A.7. states that a charity should collect the "names and addresses of any subcontracting organizations utilized by the foreign organization."

- Section IV.A.8. states that a charity should obtain "copies of any public filings or releases made by the foreign recipient organization, including most recent official registry documents, annual reports, and annual filing with the pertinent government."

- Section IV.A.9. states that a charity should obtain information about the FRO's "existing sources of income, such as official grants, private endowments, and commercial activities."

- Section IV.B.3. provides that a charity should:

  obtain the full name in English, in the language of origin, and any acronym or other names used, as well as nationality, citizenship, current country of residence, place and date of birth for key staff at the foreign recipient organization's

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[31] We note that the U.S. General Accounting Office has recommended that the Department of Homeland Security lead an effort to integrate and consolidate the federal government's terrorist watch list structures and policies relating to border security. The GAO identified twelve different lists developed by nine different government agencies. United States General Accounting Office, GAO-03-322, Information Technology: Terrorist Watch Lists Should Be Consolidated to Promote Better Integration and Sharing," (April 2003). Even though the GAO study focused on watch lists related to border security, we believe GAO's findings are applicable to the lists referred to in the Guidelines, which include "any other official list available."

principal place of business, such as board members, etc., and for senior employees at the recipient's other locations. The charity should run the names through public databases and compare them to the lists above.[32]

- Section IV.C.1. states that the charity should:

  determine the identity of the financial institutions with which the foreign recipient organization maintains accounts. The charity should seek bank references and determine whether the financial institution is: (i) a shell bank; (ii) operating under an offshore license; (iii) licensed in a jurisdiction that has been determined to be non-cooperative in the international fight against money-laundering; (iv) licensed in a jurisdiction that has been designated by the Secretary of the Treasury to be a primary money laundering concern; and (v) licensed in a jurisdiction that lacks adequate money laundering controls and regulatory oversight.

As an initial matter, FROs are likely to view these information requests as extremely burdensome and, at best, as only remotely related to the purposes of the grant, making it questionable whether the grantmaker would receive complete responses to all of the information requests. There are also issues of translation and cultural distinctions (e.g., the concept of a "last name" may differ among ethnic groups) that would make it difficult to obtain some of the information recommended in the above examples. Further, based on our experience, some of the information requested in these provisions (e.g., public filings, official registry documents, annual reports) is not readily available in the developing world and, even if required by the local government, may be considered confidential information and not publicly available.

More importantly, it is not clear what a grantmaker would do with such of the information described above as it might be able to collect. For example, few, if any, grantmakers would have the resources to be able to investigate all subcontracting organizations utilized by the FRO or the FRO's listed sources of income in order to determine whether any of the subcontractors or funders might have a connection to terrorist activities. Indeed, an analysis of such information -- as well as of information about an FRO's banking arrangements and the possibility of money laundering -- require skills associated with law enforcement agencies.

Grantmakers have considerable experience with the precautions that are necessary to provide reasonable assurance that grant funds sent overseas are used for exempt purposes. Realistically, however, as the Treasury Department recognizes in the regulations under section 4945 of the Internal Revenue Code, it is impossible for grantmakers to act as insurers of the uses made of grant funds.[33] Grantmakers simply do not have the capacity, knowledge or staff to undertake the much broader task that the Guidelines seem to require -- that the grantmaker determine that an FRO has no inappropriate connections with terrorist organizations and that no funds flowing through any part of the FRO could possibly be used to support terrorist activities. While we

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[32] We note that the term "public databases" is not defined and appears to mean something other than the lists described elsewhere.

[33] Treas. Reg. 53.4945-5(b)(1).

understand the government's desire to isolate organizations that may be associated with terrorists, we believe the government is in the best position to identify these organizations and include them on the government list. Grantmakers can do their part by not making grants to organizations on the government list and by taking other steps (discussed below) to minimize the risk that their funds would be used for non-charitable purposes.

Second, requesting the type of information recommended by Section IV of the Guidelines may have a variety of adverse consequences, including undermining the relationship between grantor and FRO and deterring important charitable activity. For example, as noted above, Section IV.B.3. of the Guidelines recommends that the charity obtain detailed background information about key staff members and board members of the FRO. In some countries, such inquiries have been interpreted as intelligence-gathering efforts on behalf of local governments that may not support the charitable activities of the FRO. In addition, in some countries, accessing government documents of a FRO that is considered a dissident organization may cause the FRO to consider the grantmaker to be in league with the government or, more seriously, may put the FRO and its staff at risk of government reprisal. Given the dangers faced by the staff of many organizations working in hostile locations, this additional burden could inadvertently reduce the type of nation-building work that would otherwise help reduce terrorism.

Third, we seriously doubt that compliance with many of the provisions listed in Section IV would be of significant value in achieving the Treasury Department's goal of preventing the diversion of funds to terrorists. For example, even if the grantmaker obtains all the information set forth in the Guidelines, it is unlikely to be able to make the necessary connection between that information and a link to terrorism. Furthermore, requiring the FRO to certify, for example, that it does not "employ or deal with" entities or individuals on the lists (see Section IV.B.4.), is unlikely to deter a FRO intent on facilitating a diversion for terrorist purposes. In other words, a grantmaker could comply fully with the Guidelines but unwittingly fund terrorist activities anyway.

Fourth, Section IV as written appears to take a "one size fits all" approach that would vastly increase the administrative expenses associated with all international grantmaking, without helping grantmakers identify and take extra precautions with respect to the very small number of potential grants that might be at risk for improper diversion. The preponderance of international grant funds are given to support projects at established and well-recognized FROs, such as colleges, universities, museums, and cultural and educational organizations in developed countries; international relief organizations (the International Red Cross, for example); international scientific and agricultural research organizations; and similar institutions with established track records of charitable activities. Other grants are made to smaller FROs that are well known to their funders and in their particular fields. Grantmakers often have prior experience funding projects conducted by these FROs, which provides them with a high degree of confidence that grant funds will be used for the intended charitable purposes, and not to support terrorism. In short, these grants to institutions well-known to the grantmaker pose little -- if any -- risk of diversion to support terrorism, and certainly no greater risk than grants to comparable institutions in the U.S.

We assume the Guidelines are not directed to the type of grants described above, but they make no such distinction. Taking the steps recommended in Section IV (at least those that are possible) would substantially increase the administrative costs associated with making international grants, even where there is no realistic risk of diversion. This would amount to many millions of dollars in administrative expenses that would directly reduce the funds that could otherwise be used for charitable purposes. Indeed, in many cases the expenses associated with making "routine, on-site audits" of FROs (an action recommended by the Guidelines whenever possible, consistent with the size of the disbursement and the cost of the audit) would exceed the amount of the grant. At a time when the need for international assistance is so great, it is important to make sure that charitable funds are deployed wisely. The Guidelines should be sensitive to resource limitations by helping grantmakers target which grants may have an increased risk of diversion and thus require the exercise of additional due diligence.

To accomplish this, we believe that Section IV of the Guidelines should be revised to outline (i) factors that grantmakers should consider in assessing whether a grant to a FRO involves an increased risk that funds might be diverted to support terrorism, and (ii) with respect to grants identified in (i) above, additional steps that grantmakers should take to minimize such risk.

Some factors that would be relevant in making the risk assessment described above are as follows:

- Whether the FRO is an established organization with a history of charitable accomplishments (less risk).

- Whether the grantmaker has prior experience dealing with the FRO, and the FRO has a track record of using grant funds for the intended purposes (less risk).

- If the grantmaker has no prior experience with the FRO and it is not an established organization, whether the grantmaker can obtain references from other trusted sources (including other nongovernmental organizations) (less risk).

- Whether the FRO is a smaller organization with specific charitable objectives and strong leadership and internal controls (less risk).

- Whether the FRO currently receives funding from an agency of the U.S. government that conducts its own vetting process (less risk).

- Whether the FRO has received recognition of exemption under Section 501(c) (3) from the IRS, or similar recognition of charitable status from the appropriate government agency in its own jurisdiction (less risk).

- Whether the FRO meets the standards of an accrediting organization that prescribes best practices for organizations in its own jurisdiction (less risk).[34]

- Whether the grant agreement gives the FRO unlimited discretion to use the funds in any of its charitable programs (more risk in the case of FROs with which the grantmaker has no prior experience and that do not have a track record of charitable accomplishments) or restricts use of the funds for specific projects, activities or expenditures (less risk).

- Whether the FRO or the project to be funded is located in a country that has adopted anti-terrorism legislation (less risk).

- Whether the FRO or the project to be funded is located in a country designated by the U.S. Secretary of State as a state sponsor of terrorism (more risk).

- Whether the FRO or the project to be funded is located in a country experiencing significant social unrest, civic turmoil, and/or internal violence (more risk).

None of these factors standing alone should be viewed as evidence that a potential grant possesses -- or does not possess -- a risk of diversion. However, the presence of "more risk" factors without counterbalancing "less risk" factors should justify additional due diligence by the grantmaker. Such due diligence should be sufficient, under the circumstances, to provide reasonable assurance to the grantmaker that the FRO will use the funds for the intended charitable purpose. We believe the Guidelines should specify the steps that would be recommended as part of such additional due diligence and grant oversight, including some or all of the steps set forth below.[35] Consistent with the voluntary nature of the guidelines, failure to take specified steps would not demonstrate a lack of due diligence on the part of a grantmaker, nor should any negative inference be drawn from not taking any or all of those steps, as it should be up to the grantmaker to determine what steps are appropriate in any particular case (including whether further investigation beyond the steps listed below is warranted). Nevertheless, the

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[34] For example, the Confederacion Colombiana des Organizaciones no Gubernamentales (CCONG) Declaracion de Principios de las Organizaciones no Gubernamentales (ONG) de Colombia (Codigo de Etica de las ONGs Colombianas) establishes guiding principles for CCONG members (available at http://www.ccong.org.co/generales/banco_herramientas.htm; members of the Czech Donors' Forum are required to comply with a Code of Ethics (available at http://www.donorsforum.cz/index_en.php?kap=criteria_for_membership; the International Committee on Fundraising Organizations has published international guidelines for fundraising institutions (available at http://www.icfo.de/standards.htm; the Orpheus Civil Society Centre has published guidelines for participants of the Orpheus Civil Society Project of the European Foundation Centre (available at http://www.efc.be/OrpheusCSP/code.htm; participants in the Russia Donors' Forum must adhere to a Code of Ethics (available at http://www.donorsforum.ru/df/about/Codeofethics.shtml); and the Voluntary Action Network India (VANI) has adopted a code of ethics for VANI members (available at: http://www.ccic.ca/volsect/code_of_ethics/ce11a-links_vanI.htm); the Philippine Council for NGO Certification has developed certification standards for NGOs operating in the Philippines (available at http://www.pcnc.com.ph).

[35] Current federal tax law provisions require private foundations to collect some of these types of information in order to make grants to foreign organizations that have not been recognized by the IRS as public charities. See, e.g., I.R.C. Sec. 4945(h), Treas. Reg. 53.4945-6(c)(2)(ii), and Rev. Proc. 92-94, 1992-2 CB 507.

inclusion of a list of recommended steps along the lines of what follows would assist grantmakers in developing an appropriate program of additional due diligence where that is warranted.

- Review the organizational documents and financial statements of the FRO, if available.
- Obtain information about the FRO's involvement with prior charitable programs, including references from reliable sources (including advisory boards and other nongovernmental organizations).
- Identify the person who will administer the grant and obtain information on his/her qualifications (or the CEO of the FRO, in the case of a general support grant).
- Obtain information about the FRO's internal controls and accounting procedures for grant funds, including oversight mechanisms for charitable projects.
- Enter into a written grant agreement with the FRO restricting the use of grant funds for charitable purposes.
- Require periodic narrative and financial reports on the FRO's use of grant funds.
- In the case of multi-year grants, disburse grant funds on a periodic basis, requiring a report on the use of funds already granted before making the next disbursement.
- Where practicable, identify a reliable in-country party that could assist with grant administration and on-site monitoring, if necessary.
- Conduct a site visit (by the grantmaker or a person acting at the grantmaker's request) when reasonably justified by the circumstances of the grant, the size of the disbursement, and the cost of a visit.

We also believe that it is reasonable to include a provision in Section IV advising grantmakers of the need to document their performance of a risk assessment with respect to certain international grants with a potential for diversion, as well as their exercise of additional due diligence where that is warranted.

E. Conclusion

We believe that only a minute fraction of all foreign grants might be considered at risk of being diverted to support terrorism. The net effect of the Guidelines, as written, is to discourage the making of all international grants and grants to domestic organizations with foreign activities or interests, particularly in parts of the world where it may be difficult or impossible to obtain all of the information described in Section IV, and in cases where the administrative costs of attempting to comply would be quite high. Ironically, this comes at a time when the need for international humanitarian assistance is at an unprecedented level. To our knowledge, no other developed country has put forward similar guidelines for the making of international grants,

putting U.S. grantmakers at a disadvantage in attempting to work with fellow grantmakers from other countries in moving forward to meet critical needs. Accordingly, we request that the Treasury Department withdraw the Guidelines and reissue them after an opportunity to consider these and other comments. We would be pleased to meet with you and your staff to discuss our comments and respond to any questions you may have.