

March 2015

The Charitable Deduction Games: Catching Change

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Recommended Citation

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THE CHARITABLE DEDUCTION GAMES: CATCHING CHANGE

Khrista Johnson*

ABSTRACT

The article addresses a matter that could result in profound changes in the ability of the United States to ameliorate the most pressing humanitarian and global problems of our times. It provides the mechanics and addresses the solutions required to enable U.S. donors to do more good. In an efficient market, capital ends up in its most productive use. In charitable giving, donations are not always allocated to their most effective use due in no small part to current cross-border giving laws impeding that result. The article sets forth the concept of an “efficient charitable market,” which is predicated upon unshackling the hands of the giver. The article proposes a system for implementing a new law that would allow U.S. donors to make contributions to non-U.S. charities.

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INTRODUCTION

The United Nations (UN) has stated, “Millions still live in extreme poverty, yet the world has enough money, resources and technology to end poverty.”¹ If cross-border charitable giving could perform with the efficiencies intrinsic to the private sector, it could have profound impacts on the betterment of humankind. Unfortunately, the charitable market is not remotely as efficient as the private sector for many reasons. However, the main reason from a historic standpoint is that U.S. laws do not favor cross-border charitable giving. This problem was evaluated in the first article of this series, *The Charitable Deduction Games: Are the Laws in Your Favor?*² In this article, I outline the steps needed to eventually establish what I will refer to as an “efficient charitable market” where we are better equipped to ensure our collective charitable investment ends up in the hands of charities that will put it to its most productive use.³ This end goal of achieving an efficient charitable market would allow us to address some of the most pressing problems confronting our global society today.

A. A Short Definition of Efficient Market and an Explanation of Why the Charitable Market Falls Short

In an efficient market, private sector investors rarely receive returns that exceed average market returns given the amount of information—and fluidity of funds—available at the time of the investment.⁴ In the *inefficient* charitable market, beating the market is easy: All the private investor (i.e., donor) must do is give to a charity that a reputable rating organization like GiveWell recommends.⁵ These charities will

1. *Get Involved*, UNITED NATIONS, <https://www.un.org/millenniumgoals/getinvolved.shtml> (last visited Sept. 23, 2014).

2. *See generally* Khrista Johnson, *The Charitable Deductions Game: Are the Laws in Your Favor?*, 5 COLUM. J. TAX L. 69 (2013).

3. *Id.*; see also Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN., no. 2, May 1970, at 383–417, for an explanation of the efficient markets theory.

4. Fama, *supra* note 3, at 383.

5. Luke Muehlhauser, *How Efficient is the Charitable Market?*, EFFECTIVE ALTRUISM FORUM (Aug. 26, 2013), <http://www.effective-altruism.com/how-efficient-charitable-market/>; *see also* Farhad Manjoo, *How to Know if Your Gift to Charity Will Count*, WALL ST. J., Dec. 16, 2013, at B8.

“achieve far greater returns (in social value) per marginal dollar than the average charity [will].”⁶ In other words, the private investors will receive a dramatically better return on their investment, seeing a measurable impact, from investing in one of these charities as opposed to other nonrecommended charities. This restriction of information, together with cross-border giving laws that make it difficult to give to non-U.S. charities, highlight inefficiencies of the charitable market partially because they show investments often do not end up with the charities that will put them to most productive use.⁷

B. *Expectations of Philanthropists Today*

At one end of the spectrum, some ponder that we should expect charitable markets to be as efficient as the private sector. Eric Thurman, Chief Executive Officer of Geneva Global, which provides research and grant management for philanthropists internationally, has succinctly underscored this point: “Approaching philanthropy as a form of investment is an important part of the solution to the problems of philanthropy.”⁸ On an optimistic note, he has found that now more than ever “donors are treating their giving like their investments.”⁹ Furthermore, Geneva Global has found that the “highest returns on investment” result from “local, grassroots organizations rather than big national agencies or international non-governmental organizations (NGOs).”¹⁰

At the other end of the spectrum is the status quo, where there is often little to no concern about the performance of charities.¹¹ Private investors frequently contribute to charities without expecting a return (in social value) for their investment.¹² Similarly, charities are unaccustomed to accounting for the productive use of funds invested

6. Muehlhauser, *supra* note 5.

7. *See generally* Johnson, *supra* note 2.

8. Eric Thurman, *Performance Philanthropy: Bringing Accountability to Charitable Giving*, HARV. INT’L REV., Spring 2006, at 18, 19.

9. *Id.* at 18.

10. *Id.*

11. KEN STERN, WITH CHARITY FOR ALL: WHY CHARITIES ARE FAILING AND A BETTER WAY TO GIVE 16 (2013).

12. *See id.* at 15–16.

in them.¹³ Even after being asked to produce reports of effectiveness, charities are unable to do so.¹⁴ The current market is pushing charities away from being the effective providers they need to be for investors and for the causes they set out to address: “[M]arket incentives of the nonprofit world push charities toward happy anecdote and inspiring narrative rather than toward careful planning, research, and evidence-based investments”¹⁵

C. Why? . . . Because the Laws Are Currently Not in Your Favor

To achieve an efficient charitable market, we must first confront the problem in our laws. In charitable giving, investment is not always allocated to its most effective use because cross-border giving laws impede that result. As explained in the first article in this series, the U.S. must change its cross-border giving law to make investing in, or giving to non-U.S. charities a sensible option.¹⁶ The European Union (EU) recently made an equivalent change in 2009 to make cross-border giving easier, which shows alternatives are available. Simply stated, our current cross-border giving laws make it too difficult, and much less effective, for a U.S. private investor to invest in non-U.S. charities.¹⁷ Now that the problem has been identified, this article turns to a viable solution with the end goal of an efficient charitable market in mind.

D. Catching Change: Identifying Barriers & Bridges to an Efficient Charitable Market

In this article, I identify attendant barriers and bridges to establishing an efficient charitable market. Each part of this article provides a solution for impediments associated with unshackling the

13. *Id.* at 16.

14. *Id.*

15. *Id.* at 14.

16. Johnson, *supra* note 2, at 98–99.

17. See Eric M. Zolt, *Tax Deductions for Charitable Contributions: Domestic Activities, Foreign Activities, or None of the Above*, 63 HASTINGS L.J. 361, 392 (2012) (arguing that placing U.S. and foreign charities on par with each other would foster having tax subsidies go to the charities that are “the most efficient providers of charitable services”).

hands of U.S. givers. Part I outlines how the U.S. should determine the global goals (i.e., charitable purposes) of non-U.S. charities that are allowed U.S. investment (i.e., deductible donations). Part II explains the mechanics of a standardized charitable form for non-U.S. charities eligible to receive such investment. Part III provides a path for insuring that these investments do not land in terrorist hands. Finally, this article sets forth a solution for the three main problems associated with changing U.S. cross-border giving laws to create an environment conducive to an efficient charitable market.

I. CHARITABLE PURPOSES OF NON-U.S. CHARITIES

For an efficient charitable market to exist, the U.S. must change its cross-border giving law to allow donations to non-U.S. charities to result in a deduction for U.S. donors.¹⁸ This has already been recognized in the EU, and EU law was changed in a 2009 landmark European Court of Justice (ECJ) case, *Persche v. Finanzamt Lüdenscheid*.¹⁹ In changing U.S. cross-border giving law, one must confront the problem of determining which non-U.S. charities should be eligible to receive U.S. deductible donations (eligible non-U.S. charities). Opening the floodgates too widely to non-U.S. charities would be a mistake. The U.S. must narrow the field of eligible non-U.S. charities to which U.S. investment may be directed. Specifically, one must determine which charitable purposes permit non-U.S. charities to qualify as eligible non-U.S. charities. Currently, U.S. charities must limit their charitable purposes to those listed in Internal Revenue Code Section 501(c)(3) (Code Section 501(c)(3)).²⁰ I propose that we identify which charitable purposes reflect internationally

18. See Johnson, *supra* note 2, at 72–73 (explaining that U.S. donors to foreign charitable organizations do not receive deductions for charitable contributions to non-U.S. charities under current cross-border giving law and discussing the limited alternatives available for such U.S. donors).

19. See Case C-318/07, *Persche v. Finanzamt Lüdenscheid*, 2009 E.C.R. I-359 (directing EU Member States to revise their laws to permit deductions for cross-border giving in the EU); see also Sigrid J.C. Hemels & Stan A. Stevens, *The European Foundation Proposal: A Shift in the EU Tax Treatment of Charities?*, 21 EC TAX REV. 293 (2012) (stating that the European Union (EU) is continuing to progress toward enabling “efficient[] channeling [of] private funds to [charitable purposes] on a cross-border basis in the European Union.”).

20. See Johnson, *supra* note 2, at 75 (discussing available charitable purposes).

agreed upon, pressing global problems. In this section, I will explore how the U.S. may determine what those global problems are, and I conclude that the U.S. should restrict the charitable purposes of eligible non-U.S. charities to those problems.

A. Defining “Good” Globally

The U.S. should determine the charitable purposes that qualify based upon whether they achieve a purpose that is recognized globally as an urgent “common unit of good.”²¹ As one commentator has noted, the charitable market is not as efficient as financial markets because there is not agreement on what a “common unit of good” means across the world.²² In the private sector, the “common unit of good,” whether the investor is in the U.S. or in Italy, is an increased return, or money.²³ All financial investors agree upon this matter.²⁴ There has already been agreement across the board on what the main problems of our global society are today, and priority should be given to addressing those first. Moreover, it is highly unlikely that an attempt at establishing an efficient charitable market could be accomplished across all sectors in its beginning stages. I argue that the United Nations Millennium Development Goals (UN MDGs)²⁵ constitute such common units of good and provide a framework for determining the answer.

The UN MDGs serve as an international standard of common units of good the U.S. and other nations are seeking to accomplish, and thus, they should form the initial body of charitable purposes for eligible non-U.S. charities. The UN MDGs are informative in terms of

21. See Muehlhauser, *supra* note 5.

22. Brian Tomasik, *Comment to Broad Market Efficiency*, THE GIVEWELL BLOG (May 4, 2013, 9:32 PM), <http://blog.givewell.org/2013/05/02/broad-market-efficiency/comment-page-1/#comment-542070> (“Efficiency in the realm of charity is inherently less plausible than in financial markets because in charity there [is] not a common unit of what ‘good’ means . . .”).

23. See MILLENNIUMPROJECT, *INVESTING IN DEVELOPMENT: A PRACTICAL PLAN TO ACHIEVE THE MILLENNIUM DEVELOPMENT GOALS 46–47* (2005), available at <http://www.unmillenniumproject.org/documents/MainReportComplete-lowres.pdf>.

24. See *id.*

25. *Id.* at 15, 82–83 (stating the following goals: (1) “[e]radicate extreme poverty and hunger;” (2) “[a]chieve universal primary education;” (3) “[p]romote gender equality and empower women;” (4) “[r]educe child mortality;” (5) “[i]mprove maternal health;” (6) “[c]ombat HIV/AIDS, malaria, and other diseases;” (7) “[e]nsure environmental stability;” and (8) “[d]evelop a global partnership for development”).

considering what the desired common units of good across the global landscape are. These eight goals represent “a blueprint agreed to by all the world’s countries and all the world’s leading development institutions” to confront the most pressing issues of our time, including the poverty, hunger, and disease plaguing billions of people as well as climate change.²⁶ The target date for achieving these goals is 2015, and thus far, progress has been inadequate.²⁷

B. Adequate Funding Resources and Inadequate Progress

Another reason for using the UN MDGs to define the charitable purposes of eligible non-U.S. charities is the funding crisis preventing the attainment of these goals. In 2002, the UN Secretary-General commissioned the Millennium Project, whose purpose was to form an action plan for achieving the UN MDGs.²⁸ In 2005, an independent advisory body, which renowned economist Professor Jeffrey Sachs led, compiled its final recommendations into a report.²⁹ In analyzing impediments to private investment in achieving the UN MDGs, Professor Sachs stated that private investors need to know that they “can earn at least the minimum return they need to invest.”³⁰ Most relevantly, he declared that a “key variable[] of interest” to such investors is “[f]avorable tax treatment.”³¹ In other words, the U.S. needs to change its U.S. cross-border giving laws with respect to the UN MDGs.

Revising our cross-border giving laws with respect to the UN MDGs would allow for an efficient charitable market with respect to pressing common units of good. As the Organisation for Economic Co-operation and Development (OECD) stated in a 2004 policy brief, it is

26. Background: U.N. Millennium Development Goals, <http://www.un.org/millenniumgoals/bkgd.shtml>.

27. U.N. Secretary-General, *Accelerating Progress Towards the Millennium Development Goals: Options for Sustained and Inclusive Growth and Issues for Advancing the United Nations Development Agenda Beyond 2015*, ¶ 10, U.N. Doc. A/67/257 (Aug. 6, 2012).

28. See generally MILLENNIUMPROJECT, <http://www.unmillenniumproject.org/> (last visited Oct. 9, 2014).

29. MILLENNIUMPROJECT, *supra* note 23.

30. *Id.* at 46.

31. *Id.*

clear that charitable giving plays an important role in funding the UN MDGs, and donations from “both small-scale donors and the super-rich” are integral.³² A 2003 OECD study revealed that private foundations have contributed significantly in several areas, including, inter alia, agriculture (the “Green Revolution”) and preventing infectious diseases.³³ The U.S. leads the OECD countries in terms of giving, where private donations have generally measured in at 2% of Gross National Product (GNP).³⁴ In 2002, GNP in the U.S. was approximately \$11 trillion, which means private donations totaled \$220 billion.³⁵ The UN has recently projected that \$30 billion is necessary to end the current food crisis.³⁶ However, the numbers have not been reflected in the charities’ expenditure numbers. The OECD has estimated that the annual expenditures for philanthropic organizations total the much smaller sum of \$3 billion.³⁷

An important and pressing question is: Why are charitable investments not being used to fund UN MDGs effectively?³⁸ Implementation of a new cross-border giving law should promote giving to non-U.S. charities pursuing UN MDGs.³⁹ This would promote an efficient charitable market with respect to the UN MDGs. Ultimately, U.S. funding is not being directed toward common units of good or resulting in the social value that we and the rest of the world have deemed important.⁴⁰ This is in direct contrast to capital markets efficiency where “investment capital is allocated to its most [effective] use.”⁴¹ By narrowing the areas of charitable work that qualify for a deduction (i.e., restricting charitable purposes) to those that constitute

32. HELMUT REISEN, INNOVATIVE APPROACHES TO FUNDING THE MILLENNIUM DEVELOPMENT GOALS 15–16 (2004) [hereinafter OECD POLICY BRIEF], available at <http://www.oecd.org/development/pgd/31430478.pdf>.

33. *Philanthropic Foundations and Development Co-operation*, 4 DAC J. 73, 89–97 (2003).

34. See OECD POLICY BRIEF, *supra* note 32, at 16.

35. *Id.*

36. Andrew Martin & Elisabeth Rosenthal, *U.N. Says Food Plan Could Cost \$30 Billion a Year*, N.Y. TIMES, June 4, 2008, at A6.

37. OECD POLICY BRIEF, *supra* note 32, at 16.

38. See *id.*

39. See MILLENNIUM PROJECT, *supra* note 23, at 176–77.

40. See Muehlhauser, *supra* note 5.

41. *Chicago Ideas: Efficient Markets Theory*, UNIV. OF CHI. BOOTH SCH. OF BUS., <http://www.chicagobooth.edu/ideas/efficientmarket.aspx> (last visited Oct. 9, 2014).

“common units of good,” the U.S. may make progress in establishing an efficient charitable market in the charitable sector where it is needed most urgently. This would also mean giving up less control over monitoring since there would be fewer non-U.S. charities to consider, i.e., only those addressing the UN MDGs. I would urge the U.S. to consider changing its cross-border giving laws to promote greater ease in giving to non-U.S. charities with a charitable purpose reflective of the UN MDGs.

II. AN EFFICIENT CHARITABLE FORM FOR NON-US CHARITIES

In changing its cross-border giving law, the U.S. also must outline a standard charitable form, reflective of minimum requirements, for eligible non-U.S. charities. The U.S. may be assured that non-U.S. charities complying with the form largely are equivalent to U.S. charities. The need for a standard charitable form is evidenced in the EU’s experience.⁴² Even after EU law was changed in 2009, many obstacles to cross-border giving remain.⁴³ Due to the variation in civil and tax laws across the Member States, cross-border giving has been made expensive and administratively difficult.⁴⁴ EU charities have continued to incur unreasonable costs and inefficiencies as a result of having to seek out legal advice to comply with administrative requirements.⁴⁵ As the European Commission found, this causes charities to use valuable resources to meet legal and administrative objectives, rather than to achieve their stated charitable purposes and may also serve as a disincentive to expanding charitable work.⁴⁶ In other words, these costs and burdens are impediments to an efficient charitable market. These same costs and burdens will exist in terms of the U.S. cross-border context even after the U.S. revises its relevant laws. This section provides a solution. I will consider the standard

42. See Hemels & Stevens, *supra* note 19, at 293.

43. *Id.* at 293–94.

44. *Id.* at 293.

45. Press Release, European Comm’n, Proposal for a Regulation on the Statute for a European Found. (FE)—Frequently Asked Questions (Feb. 8, 2012) [hereinafter FE Press Release], available at http://europa.eu/rapid/press-release_MEMO-12-79_en.htm?locale=fr.

46. *Id.*

charitable form that has been proposed in the EU as a viable solution and how the U.S. may adapt this form so eligible non-U.S. charities can have certainty in knowing they will receive a stamp of approval from the U.S., i.e., donations to them will result in a U.S. deduction.

A. Using the Newly Proposed European Foundation Statute to Produce a Solution

Three years after the change in EU cross-border giving law marked the beginning of a solution to these problems. In February 2012, the European Commission set forth a proposal (the Proposal) for a European Foundation Statute (FE Statute) that details a standardized charitable form, i.e., the European Foundation or *Fundatio Europaea* (FE).⁴⁷ In sum, the FE is a legal form detailing minimum requirements for charities that would be recognized by all EU Member States as able to receive deductible donations.

The purpose of the FE Statute is to facilitate what *Persche* has mandated as law: the ability to engage in cross-border giving across the EU with greater ease.⁴⁸ The Proposal sets forth three distinct advantages associated with the FE Statute.⁴⁹ First, it would cut down on costs and uncertainty associated with procuring funds from non-domestic countries.⁵⁰ Secondly, it would offer FEs a European stamp of approval that would lead to greater legitimacy in the cross-border context.⁵¹ Third, the tax treatment of an FE would be obvious and compelling.⁵² Enactment of the statute would place FEs on the same footing as domestic charities, enabling them to take in donations from donors from any participating EU Member State.⁵³

47. See *id.*; *Commission Proposal for a Council Regulation on the Statute for a European Foundation (FE)*, COM (2012) 35 final (Aug. 2, 2012) [hereinafter *Commission Proposal*].

48. See FE Press Release, *supra* note 45, at 2 (“Donors should find donating to foreign foundations less costly and simpler. Moreover, the uniform rules and European label connected to the [FE] Statute should make European Foundations more trustworthy and recognisable for donors.”).

49. See *generally id.*

50. *Id.* at 2.

51. *Id.* at 3.

52. See *id.* at 6.

53. *Id.*

*B. Basic Characterizations of a Standardized Charitable Form
(European Foundation Statute with U.S. Modifications)*

The following is an examination of the basic characteristics of the FE form and an analysis of which provisions should be modified from a U.S. standpoint. The definition of an FE is very similar to a private foundation or public charity in the U.S.⁵⁴ As is the case with private foundations and public charities in the U.S., FEs may be “grant-making foundations” and thus fund the charitable activities of others in the way U.S. “friends of” organizations do,⁵⁵ or they may carry out charitable activities themselves in a manner similar to U.S. public charities.⁵⁶ Like private foundations and public charities in the U.S., private individuals, corporations, or governments may establish FEs.⁵⁷ Generally, an FE is a nonmembership organization with a public-benefit purpose and, in terms of entity characteristics, is private, self-governing, and non-profit-distributing.⁵⁸ Commentators have noted that it appears to be modeled on the concept of a French foundation given the requirement that it has a public-benefit object.⁵⁹ Notably, it differs from a Dutch foundation, which is not required to have a public-benefit purpose.⁶⁰ The definition also excludes a United Kingdom (U.K.) company limited by shares that is registered as a charity because such entity would have share capital.⁶¹ In contrast, a U.K. company limited by guarantee, registered as a charity would satisfy the definition.⁶² Another term for an FE is a non-profit organization,⁶³ however, given the restrictions listed above, the term foundation is more accurate.

54. Compare *Commission Proposal*, *supra* note 47, at 6, with Johnson, *supra* note 2, at 81.

55. Compare *Commission Proposal*, *supra* note 47, at 17, and Hemels & Stevens, *supra* note 19, at 293–294, with Johnson, *supra* note 2, at 81.

56. Compare *Commission Proposal*, *supra* note 47, at 15–17, and Hemels & Stevens, *supra* note 19, at 294, with Johnson, *supra* note 2, at 81.

57. See Hemels & Stevens, *supra* note 19, at 294; I.R.C. § 501(c)(3) (2012); Johnson, *supra* note 2, at 81.

58. See Hemels & Stevens, *supra* note 19, at 293.

59. *Id.*

60. Johnson, *supra* note 2, at 95; Hemels & Stevens, *supra* note 19, at 293.

61. Hemels & Stevens, *supra* note 19, at 293.

62. See *id.*

63. See FE Press Release, *supra* note 45, at 4.

An examination of the legal components of the FE is helpful in terms of understanding its shortcomings and whether such a form would satisfy U.S. standards of what constitutes a charity (to which deductible charitable contributions may be made). First, FEs, like U.S. charities (i.e., private foundations and public charities), must be formed for a purpose deemed charitable under a statute.⁶⁴ Similar to the U.S. statute that defines these purposes for a U.S. charity, Code Section 501(c)(3), the Proposal contains a list of allowable charitable purposes for an FE.⁶⁵

Several of the charitable purposes, or public-benefit purposes, of the Proposal are ones that would lend themselves to support from around the world or may qualify as common units of good, as explored in Part I: specifically, (e) social welfare, including prevention or relief of poverty; (f) humanitarian or disaster relief; (m) education and training; and (o) health, well-being, and medical care.⁶⁶ As explained in Part I, the U.S. should allow, at least initially, a revision of the law in regard to internationally accepted common units of good. The EU also has underscored this point in detailing the charitable purposes for which an FE may be organized.⁶⁷ In discussing why cross-border giving within the EU should be easier, Internal Market Commissioner Michel Barnier isolated a few charitable purposes that he saw as more global in nature: ““We need to support and encourage the valuable work that foundations do for European citizens. In particular, we need to remove the obstacles which hinder their cross-border work on issues such as research, health or culture.””⁶⁸

Eventually, the U.S. would need to consider which charitable purposes—in addition to those outlined in the UN MDGs—currently detailed in Code Section 501(c)(3) would fall under this category of global causes. It would seem obvious that research on preventive

64. *Id.*; see Johnson, *supra* note 2, at 75 (discussing the requirements of I.R.C. § 501(c)(3)).

65. *Commission Proposal*, *supra* note 47, at 15–16.

66. *Id.* at 15.

67. See Hemels & Stevens, *supra* note 19, at 298–99.

68. Press Release, European Commission, Promoting Projects That Benefit Society at Large: The European Foundation Statute, (Feb. 8, 2012) [hereinafter Promoting Projects], available at http://europa.eu/rapid/press-release_IP-12-112_en.htm?locale=fr.

treatment or medicine would qualify.⁶⁹ However, it may be more difficult to reach a consensus on the extension of culture.⁷⁰ Oddly and incorrectly, the list of public-benefit purposes does not include religion, although religion is deemed a public benefit in all EU Member States.⁷¹ The first charitable purpose listed in Code Section 501(c)(3) is a religious one.⁷² It is imperative to think through which charitable purposes would be included from a U.S. perspective.⁷³ The European Commission's failure to provide an interpretation of these categories is a shortcoming.⁷⁴ The absence of a definition leaves too much uncertainty for "charities and their donors and for tax authorities and supervisory authorities."⁷⁵

Second, the FE must have a cross-border aspect that involves at least two Member States in the carrying out of its purpose.⁷⁶ If this requirement applied to the U.S. system, the U.S. would narrow the extension of tax deductibility to those non-U.S. charities working on charitable purposes carried out in an international context, e.g., the UN MDGs. This idea has been explored in Part I. Thus, at least initially, the U.S. should consider an even more stringent requirement than the FE Statute provides.

Third, the Proposal details rules that prohibit for-profit activity,⁷⁷ akin to U.S. unrelated business income tax (UBIT) rules and a minimum capitalization requirement.⁷⁸ The third requirement subjects FEs to a set of rules similar to the UBIT rules that restrict U.S. charities from engaging in for-profit activities unrelated to their charitable

69. See I.R.C. § 501(c)(3) (2012).

70. See *Commission Proposal*, *supra* note 47, at 15–16.

71. *Id.*

72. I.R.C. § 501(c)(3) (2012).

73. See Johnson, *supra* note 2, at 74–75.

74. See Hemels & Stevens, *supra* note 19, at 299.

75. *Id.*

76. *Commission Proposal*, *supra* note 47, at 6, 16.

77. *Id.* at 17.

78. See INTERNAL REVENUE SERV., PUBLICATION 598: TAX ON UNRELATED BUSINESS INCOME OF EXEMPT ORGANIZATIONS 1–2 (2012), available at <http://www.irs.gov/pub/irs-pdf/p598.pdf> (explaining a charity "is not taxed on its income from an activity substantially related to the charitable, educational, or other purpose that is the basis for the organization's exemption" but it is "subject to tax on its income from [an] unrelated . . . business.").

purpose.⁷⁹ Here, the U.S. naturally would want to extend its UBIT requirements to non-U.S. charities to avoid potential economic abuse. In terms of capitalization, the Proposal provides that an FE must have a minimum amount of assets, specifically 25,000 euro.⁸⁰ The U.S. should consider requiring eligible non-U.S. charities to have a minimum amount of assets, perhaps exceeding the FE amount.

Fourth, FEs are governed by their statutes, i.e., bylaws, and are subject to national charity law only in regard to matters the Proposal or their bylaws have “not regulated or only partly regulated.”⁸¹ Thus, national charity law may not limit the activity of an FE beyond what is described in the Proposal. However, the governing board of the FE is subject not only to the FE’s bylaws but also to national law regarding charitable governance.⁸² Clearly, the U.S. would want to ensure non-U.S. charities detailed the requirements of charitable governance in their bylaws. Perhaps having such non-U.S. charities comply with their own nation’s charity law would be sufficient. This would require the U.S. to review and approve each nation’s charitable laws, particularly anti-terrorist measures, or to rely upon the findings of an international supervisory body, which is discussed in Part III.⁸³ In terms of a nation like the U.K., that requirement would be easily satisfied. At the same time, the U.S. would likely want features of its own U.S. charitable law to serve as an additional layer of regulation in terms of such governance.⁸⁴

The Proposal details three ways to form an FE. Most relevant for comparison purposes are the following: (1) “by the merger of public benefit purpose entities legally established in one or more Member States” or (2) “by the conversion of a national public benefit purpose entity legally established in a Member State into the FE.”⁸⁵ The

79. *Commission Proposal*, *supra* note 47, at 17; PUBLICATION 598, *supra* note 78, at 3–7; *see also* Hemels & Stevens, *supra* note 19, at 298.

80. *Commission Proposal*, *supra* note 47, at 16.

81. *See* Hemels & Stevens, *supra* note 19, at 299.

82. *See generally*, *Commission Proposal*, *supra* note 47; *see also* FE Press Release, *supra* note 45.

83. *See* discussion *infra* Part III.B.

84. *See, e.g.*, I.R.C. § 501(m)(1) (2012) (explaining a charitable organization will be denied tax exemption if a substantial part of its activities consists of providing commercial-type insurance).

85. *Commission Proposal*, *supra* note 47, at 6. The third method is via “a testamentary disposition, by notarial deed or by a written declaration.” *Id.*

Proposal also provides requirements for the bylaws, such as the minimum content they must contain.⁸⁶ The bylaws must be in writing, and there are restrictions on amending them, e.g., only if the purpose for which the FE was established has been achieved or cannot be achieved or if the current purpose is not “a suitable and effective method of using the FE’s assets.”⁸⁷ Amendment of the bylaws will be an area that the U.S. should scrutinize carefully in light of its dissolution and private inurement rules.⁸⁸ The method of altering the charitable purpose of the FE seems too relaxed to satisfy U.S. charitable standards.⁸⁹ Under the Proposal, amendment simply requires consistency with the “will of the founder.”⁹⁰

A pressing issue for the U.S. in revising its cross-border giving laws is the presence of oversight by other national regulatory authorities.⁹¹ Specifically, concern about funds being used to support terrorist activity is one that cannot be ignored or simplified. This concern is addressed in Part III. The idea that a Member State could not provide effective fiscal supervision was rejected in a case that preceded *Persche, Centro di Musicologica Walter Stauffer v. Finanzamt München für Körperschaften*.⁹² In *Stauffer*, the ECJ instead noted that a Member State could implement measures to check whether a non-resident charity was complying with conditions for charitable status under its national law, and to monitor how well it was being managed.⁹³ A Member State could also require submissions of evidence.⁹⁴

86. *Commission Proposal*, *supra* note 47, at 21–22. The anti-terrorist provisions that should be reflected in the bylaws are explored in Part III.

87. *Id.* at 22.

88. *See Life Cycle of a Public Charity – Jeopardizing Exemption*, IRS, <http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Life-Cycle-of-a-Public-Charity-Jeopardizing-Exemption> (last updated Mar. 6, 2014) (explaining if a charitable organization is found to operate for the benefit of private interests of its founder or shareholders, then it risks losing its tax exempt status).

89. *Commission Proposal*, *supra* note 47, at § 2, art. 20.

90. *See Hemels & Stevens*, *supra* note 19, at 299.

91. *See Johnson*, *supra* note 2, at 83–84.

92. Case C-386/04, *Centro di Musicologia Walter Stauffer v. Finanzamt München für Körperschaften*, 2006 E.C.R. I-8204–05.

93. *Id.* at I-8204.

94. *See id.*

Under the Proposal, oversight of the FEs is carried out through a registration requirement.⁹⁵ FEs must be registered in a Member State, and each Member State must establish a registry that compiles information about them.⁹⁶ FEs not only must register, but also must notify the European Commission of such action.⁹⁷ In addition, the respective registries are subject to an information exchange regarding FEs, which means they must communicate with each other.⁹⁸ In terms of requirements, the registry does not have to be an independent organization.⁹⁹ Although an existing organization, such as the Chamber of Commerce, may serve as the registry, a definitive answer has not been provided regarding whether existing tax authorities may fulfill this role.¹⁰⁰ This requirement may be even more stringent than the current system in the U.S. since charities are required to register only with an existing tax authority, the Internal Revenue Service (IRS).¹⁰¹

In summary, to avoid continued obstacles to cross-border giving in spite of a change in the law, the U.S. should provide eligible non-U.S. charities with a standardized charitable form. This would provide eligible non-U.S. charities with assurance that the U.S. considers them to have met minimum requirements. The EU only realized the need for a standardized charitable form after changing its cross-border giving law. The EU's Proposal for an FE Statute may serve as guidance for a U.S. standardized charitable form, and it may be adapted to U.S. concerns.

95. *Commission Proposal*, *supra* note 47, at 23–26.

96. *Id.* at 23.

97. *Id.*

98. *Id.* at 22–25.

99. *Id.*

100. Hemels & Stevens, *supra* note 19, at 300.

101. *Application for Recognition of Exemption*, IRS (last updated July 1, 2014), <http://www.irs.gov/Charities-&-Non-Profits/Application-for-Recognition-of-Exemption>; *see also* INTERNAL REVENUE SERVICE, PUBLICATION 557: TAX-EXEMPT STATUS FOR YOUR ORGANIZATION 30 (2013), available at <http://www.irs.gov/pub/irs-pdf/p557.pdf>.

III. KEEPING CHARITABLE FUNDS OUT OF THE HANDS OF TERRORISTS

In this section, I will confront the Achilles' heel of an argument to change U.S. cross-border giving laws, and show that there is a solution to ensure unshackled funds are not more likely to end up as terrorist financing. An argument has been consistently put forward that we must continue to restrict U.S. investment to charities formed in the U.S. because we need the IRS's oversight to ensure funds do not wind up in the hands of terrorists.¹⁰² That argument is misguided for several reasons. First, make no mistake about the present reality: funds donated to U.S. charities have ended up and continue to end up as terrorist financing.¹⁰³ The devastating attack on September 11, 2001 led to the adoption of three mechanisms to ensure charitable funds are not used to promote terrorist activities: (1) Executive Order 13224, (2) the USA Patriot Act,¹⁰⁴ and (3) the 2002 Treasury Department Anti-Terrorist Financing Guidelines: Voluntary Best Practices for US-Based Charities (Guidelines).¹⁰⁵ The Guidelines were designed to provide assistance with complying with the two former measures.¹⁰⁶ They were revised and re-published in 2006 (the Revised Guidelines), and the net result of the revision still has not led to greater effectiveness of the IRS in stopping the diversion of charitable funds to terrorist financing.¹⁰⁷ In fact, it is questionable whether the IRS is more effective than other foreign governmental agencies in preventing the diversion of funds to terrorist activities.¹⁰⁸ Second, there are

102. See Johnson, *supra* note 2, at 83–84.

103. See Nina J. Crimm, *Through a Post-September 11 Looking Glass: Assessing the Roles of Federal Tax Laws and Tax Policies Applicable to Global Philanthropy by Private Foundations and Their Donors*, 23 VA. TAX REV. 1, 115 (2003).

104. Janne G. Gallagher, *Grantmaking in an Age of Terrorism: Some Thoughts About Compliance Strategies*, INT'L DATELINE (Council on Funds., Washington, D.C.), Second Quarter 2004, at 1; see also Johnson, *supra* note 2, at 83 (stating the former, among other restrictions, makes it illegal for any U.S. person to engage in a transaction with individuals and organizations named on any terrorism watch lists of the U.S. government and the latter increased the purview of criminal prohibitions related to supporting terrorist activities and strengthened the penalties for noncompliance).

105. Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities, 71 Fed. Reg. 63,838, 63,843 (Oct. 31, 2006).

106. See *id.* at 63,846.

107. See Crimm, *supra* note 103, at 113–115 (describing how U.S. charities have been used to finance terrorist activity).

108. See *id.* at 118.

international supervisory agencies that have surveyed and continue to monitor the effectiveness of countries, including the U.S., in terms of their ability to prevent charitable funding from becoming terrorist financing,¹⁰⁹ and the U.S. can rely on their methodologies and findings in deciding which countries' charitable laws it views and practices it views as acceptable. I will examine the extent of diversion of charitable funds to terrorist financing in the U.S.; the work of the Financial Action Task Force (FATF) in monitoring this issue internationally;¹¹⁰ and how the Revised Guidelines may be used in tandem with FATF efforts to allay fears about contributions going abroad to ultimately create an efficient charitable market.¹¹¹ In sum, I will confront the concerns of implementation from an anti-terrorism perspective and ultimately conclude that those concerns may be abated with careful consideration and application of the Revised Guidelines to the FATF's current monitoring program.

A. *Current IRS Monitoring of Charitable Funds*

In arguing that we should restrict tax deductible donations to U.S. charities, observers have frequently reasoned that doing otherwise would allow charitable funds to escape the careful purview of IRS oversight and end up in the hands of terrorists.¹¹² However, this is a fallacy because the IRS is not currently doing a sufficient job of monitoring U.S. charities, and it is not even entirely to blame. The number of charitable organizations in comparison to IRS examiners has increased dramatically since the 1990s.¹¹³ Relevantly, the

109. See FINANCIAL ACTION TASK FORCE, INTERNATIONAL STANDARDS ON COMBATTING MONEY LAUNDERING & THE FINANCING OF TERRORISM & PROLIFERATION, THE FATF RECOMMENDATIONS 8 (2012) [hereinafter FATF RECOMMENDATIONS], available at http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf.

110. *About the FATF: Who We Are*, FATF, <http://www.fatf-gafi.org/pages/aboutus/> (last visited Oct. 14, 2014).

111. *Id.*

112. David E. Pozen, *Remapping the Charitable Deduction*, 39 CONN. L. REV. 531, 545, 596 (2006); see Harvey P. Dale, *Foreign Charities*, 48 TAX LAW. 655, 663 (1995).

113. *Written Statement of Mark W. Everson, Commissioner of Internal Revenue Before the Committee on Finance, United States Senate: Hearing on Exempt Organizations: Enforcement Problems, Accomplishments, and Future Direction*, Apr. 5, 2005, <http://www.finance.senate.gov/imo/media/doc/metest040505.pdf> [hereinafter *Everson Statement*].

International Committee on Fundraising Organizations (ICFO) published a comparative survey in 2002 of its members, which includes the U.S. In its report, it noted the following in regard to the oversight in the U.S.:

[B]ecause of the high volume [of reports] only those organizations which are exposed by media investigations or are otherwise the subject of numerous complaints, get investigated. The same limited resource is true of State monitoring agencies. The result is a lightly regulated industry brought about in part because of the lack of resources to monitor so many organizations, plus the very real constitutional protections that are afforded U.S. charities. The issues of free speech and separation of Church and State allow [charities] considerable latitude in functioning without close oversight.¹¹⁴

The section of the IRS responsible for such monitoring, the Tax Exempt and Government Entities Division (TE/GE), is simply overwhelmed with charities.¹¹⁵ Between 1995 and 2003, as the number of exempt organization returns grew, the number of enforcement personnel conducting oversight decreased in inverse correlation.¹¹⁶

In 2005, then Commissioner of Internal Revenue Mark Everson stated, “In the Tax Exempt and Government Entities Division (TE/GE), as in the rest of the IRS, our enforcement presence faded in the late 1990’s. . . . [W]e were, and continue to be, struggling with yearly increases in the number of applications for tax exemption.”¹¹⁷ He also elaborated upon the resulting consequences: “This decline in enforcement presence, combined with the significant growth of the tax-exempt sector . . . created opportunities for noncompliance. We simply did not do enough ‘policing’ in the area to support the good

114. INGRID-HÉLÈNE GUET, MONITORING FUNDRAISING: A COMPARATIVE SURVEY OF ICFO MEMBERS AND THEIR COUNTRIES 33 (2002), available at http://www.icfo.org/Uploaded_files/Zelf/survey-formatted.pdf.

115. See Everson Statement, *supra* note 113, at 3.

116. See *id.* at 2–3.

117. *Id.* at 3.

actors in their quest to voluntarily comply with the rules.”¹¹⁸ One scholar found in 2003 that U.S. taxpayers provided 30% of the support terrorist organizations raised in the U.S. through abuse of charities.¹¹⁹

Alarming, in 2007, six years after 9/11, neither the Treasury Department,¹²⁰ the Senate Finance Committee,¹²¹ nor the IRS were pleased with the current precautions in place.¹²² Two years after Mark Everson’s stirring words, the IRS was still using paper documents and the same inadequate watch lists to locate potential terrorist connections as indicated in a 2007 Audit (Inspector General Audit) by the Treasury Department’s Inspector General for Tax Administration (Inspector General).¹²³ The Inspector General urged the IRS to use a more “comprehensive terrorist watch list” to ferret out terrorist ties.¹²⁴ The Inspector General did not mince words when analyzing the shortcomings of the IRS in terms of oversight of charities:

[T]he Internal Revenue Service (IRS) is lax in its screening of charities for possible terrorist activities. In a recent report (2007-10-082) the [I]nspector [G]eneral charged that the IRS exempt organization office falls short in its efforts to identify and pursue cases involving tax-exempt organizations and related individuals potentially involved in terrorist-related activities. The report emphasizes that this is a significant problem because charities and

118. *Id.*

119. Mindy Herzfeld, *Restricting the Flow of Funds from U.S. Charities to International Terrorist Organizations—A Proposal*, 56 TAX LAW. 875, 882 (2003) (approximating a 30% tax rate).

120. *See generally*, TREASURY INSPECTOR GENERAL FOR TAX ADMIN., No. 2007-10-082, SCREENING TAX-EXEMPT ORGANIZATIONS’ FILING INFORMATION PROVIDES MINIMAL ASSURANCE THAT POTENTIAL TERRORIST-RELATED ACTIVITIES ARE IDENTIFIED (2007) [hereinafter INSPECTOR GENERAL AUDIT] (noting the deficiencies in the IRS review process for tax-exempt organizations and proposing measures to systematically compare forms against terrorist watch lists).

121. Press Release, The U.S. Senate Comm. on Fin., Baucus Wants Stronger Scrutiny of Tax-Exempt Groups for Terror Ties (May 25, 2007) [hereinafter Baucus], available at <http://www.finance.senate.gov/newsroom/chairman/release/?id=be60a055-866f-4b60-b6ec-149865ae03fa>.

122. Steven Toscher & Chad Nardiello, *IRS Scrutiny of Tax-Exempt Organizations*, L.A. LAW., October 2005, at 18–20.

123. INSPECTOR GENERAL AUDIT, *supra* note 120, at 3.

124. *Id.* at 3–8 (indicating that this creates a risk that charities financing terrorism will not be reported to the federal government authorities fighting terrorism and explaining the need for use of a more inclusive terrorist watch list).

nonprofit organization[s] have been an important source of alleged terrorist support.¹²⁵

Simply stated, the IRS was deemed to have taken inadequate steps to prevent terrorist financing. The Inspector General Audit concluded that “[t]he use of charities and nonprofit organizations” still provides a “significant source of alleged terrorist support.”¹²⁶ Indeed, the IRS itself reflected that the rules it had established were “not well-suited to prevent funds from being used to support terrorist activities.”¹²⁷ The IRS terrorist financing prevention process works by comparing information on exemption applications (i.e., Form 1023) and information returns to the terrorist watch list of the Office of Foreign Assets Control (OFAC).¹²⁸ This process has been criticized as “inadequate to meaningfully identify terrorist-related activities by charitable organizations.”¹²⁹ Members of Congress have also observed and attested to the inadequacy of the measures the IRS utilizes in terms of oversight. Indeed, Max Baucus, when Chair of the Senate Finance Committee, stressed the need for Treasury to “step up efforts to identify tax-exempt charities and nonprofit organizations with possible links to terrorist activities.”¹³⁰

B. International Supervisory Organizations

If one examines the effectiveness of international supervisory organizations, one may conclude that at least one of these organizations is performing at the highest level. In this section, I will consider the international landscape of global monitoring in general and the oversight of the FATF in particular. Such an examination shows that the U.S. may rely on the FATF’s regular assessments of

125. Alan Rice, *IRS Screening of Charities is Lax*, 06-07 Pratt’s Anti-Money Laundering Update 5 (June 2007) (referring to the warning in the Inspector General’s report).

126. INSPECTOR GENERAL AUDIT, *supra* note 120, at 1.

127. Toscher & Nardiello, *supra* note 122, at 20.

128. INSPECTOR GENERAL AUDIT, *supra* note 120, at 4–5.

129. Douglas N. Varley, *Trends and Developments in Cross-Border Philanthropy: International Grantmaking, Social Enterprise, and Stepped-Up Enforcement*, in INTERNATIONAL TRUST AND ESTATE PLANNING 433, 459 (ALI-ABA Course of Study 2009).

130. Baucus, *supra* note 121.

countries' anti-terrorist financing measures, and thus, the U.S. may defer safely to countries that have received a satisfactory FATF rating.

The FATF's standards exceed that of the U.S.¹³¹ In fact, two of the countries the U.S. currently has reciprocity with in terms of charitable giving have failed to meet the standards of the FATF and have received an FATF rating lower than that of the U.S.¹³² This finding strengthens the argument for the U.S. to rely on FATF ratings in determining which countries' charities would be eligible to receive U.S. tax deductible donations. Moreover, as the FATF assessments show, there are already more extensive measures in place in other countries,¹³³ and the U.S. should have no problem with turning over some of its monitoring responsibilities to those FATF-approved countries in the name of producing a more efficient charitable market.

1. International Landscape of Supervisory Organizations

The international landscape is full of mechanisms designed to ensure that charitable funds do not end up in the hands of terrorists. The works of several international bodies have confronted this issue. First, the UN adopted an International Convention for the Suppression of the Financing of Terrorism that was signed by 185 parties, including the U.S.¹³⁴ Second, the Organization for Security and Co-operation in Europe (OSCE) has emphasized the need for an international legal framework designed to combat terrorism, and it holds workshops designed to meet this goal.¹³⁵ Within the OSCE is the Action Against Terrorism Unit,¹³⁶ which has adopted ministerial statements pertaining to decreasing terrorism.¹³⁷

131. *See infra* Part III.D.

132. *See infra* Part III.E.

133. *See infra* Part III.E.

134. G.A. Res. 54/109, U.N. Doc. A/RES/54/109 (Feb. 25, 2000).

135. *See* Consolidated Reference for OSCE Anti-Terrorism Efforts (last updated March 2014), available at <http://www.osce.org/secretariat/99765?download=true>; *see also* OSCE Holds Meeting to Discuss Preventing Abuse of Non-Profit Organizations for Terrorist Financing, ORGANIZATION FOR SECURITY AND CO-OPERATION IN EUROPE (Sept. 11, 2009), <http://www.osce.org/atu/51301>.

136. *See* Consolidated Reference for OSCE Anti-Terrorism Efforts, at 15–18 (last updated March 2014), available at <http://www.osce.org/secretariat/99765?download=true>.

137. *Id.* at 11–12.

Another relevant presence in the international landscape pertaining to the prevention of terrorist financing through charities¹³⁸ is the Center on Global Counterterrorism Cooperation (CGCC). The CGCC is a “nonprofit, nonpartisan policy institute” whose aim is to increase international collaboration on counterterrorism.¹³⁹ The CGCC works alongside the UN and regional groups, as well as national governments and policymakers.¹⁴⁰ The CGCC released a report in June 2013 entitled “To Protect and Prevent: Outcomes of a Global Dialogue to Counter Terrorist Abuse of the Nonprofit Sector.”¹⁴¹ The findings and recommendations were the result of collaboration among several international organizations, including the FATF (of which the U.S. is a member, as discussed more fully below), who participated in a multiyear UN project centered around ensuring charities are not misused to fund terrorist activities.¹⁴² The project consisted of two global-level meetings and five regional meetings, and participants in the project included over fifty countries, eighty charities, members from the UN and multilateral agencies, and representatives from the FATF, FATF-style regional bodies (FSRBs), and the financial sector.¹⁴³ Their findings and recommendations were compiled into the above-mentioned report.¹⁴⁴ Notably, the governments of several countries were given special recognition for their contribution to the endeavor, including the governments of Canada, Australia, New Zealand, Sweden, Switzerland, and the U.K.¹⁴⁵ These countries’ involvement should lend additional credence to the ability of their

138. Most of the international supervisory organizations use the term *non-profit organization* (NPO); however, the term *charity* is used throughout this article for consistency.

139. *About*, CENTER ON GLOBAL COUNTERTERRORISM COOPERATION, <https://web.archive.org/web/20130620021703/http://www.globalct.org/about> (last visited Jan. 21, 2015) (accessed by searching for globalct.org/about in the Internet Archive index).

140. *Id.*

141. CENTER ON GLOBAL COUNTERTERRORISM COOPERATION, *TO PROTECT AND PREVENT: OUTCOMES OF A GLOBAL DIALOGUE TO COUNTER TERRORIST ABUSE OF THE NONPROFIT SECTOR*, (2013) [hereinafter *TO PROTECT AND PREVENT*].

142. *Id.* at 2.

143. *Id.*

144. *See id.* at 2.

145. *See id.* at 4.

governments to prevent the diversion of charitable funds to terrorism.¹⁴⁶

Two of the recommendations of the report are significant in considering the advantages associated with U.S. implementation of a more flexible rule. The report found there is a definite need for greater capacity building within States and for “a global network of regulators and oversight bodies.”¹⁴⁷ In terms of the former, better management of information concerning charities through mechanisms, such as registry databases, is necessary.¹⁴⁸ Regarding the latter, the CGCC report found that cooperation among national agencies is lacking.¹⁴⁹ A network of regulators that shares information on procedures and other expertise is needed, and could be used to avoid the divergence of charitable funds to terrorist activity.¹⁵⁰ Additionally, it puts forth the idea of a website whereby various countries could share relevant information.¹⁵¹ If the U.S. implemented a system where it worked collaboratively with another country, such as the U.K., in the endeavor to monitor charities, both of these objectives would be met, and it would set a standard for the rest of the world in terms of collaboration in the area. However, the FATF will serve a crucial role in any system of international monitoring.

2. The Most Relevant International Supervisory Organization— the FATF

Perhaps the most relevant supervisory organization in the international arena is the FATF. The FATF is an inter-governmental unit that drafts and disseminates policies aimed at safeguarding the “global financial system against money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction.”¹⁵²

146. For purposes of this paper, a basic premise is that the U.S. would engage in reciprocity with certain EU Member States first, notably the U.K.; this premise is discussed *infra* p. 40.

147. TO PROTECT AND PREVENT, *supra* note 141, at vi.

148. *Id.*

149. *Id.* at 13–14.

150. *Id.*

151. *Id.* at 14.

152. FATF, BEST PRACTICES: COMBATING THE ABUSE OF NON-PROFIT ORGANISATIONS (RECOMMENDATION 8) (June 2013) [hereinafter FATF BEST PRACTICES], available at <http://www.fatf->

FATF policies are known as Recommendations, and they are separated according to the measures to which they pertain: anti-money laundering (AML) and counter-terrorist financing (CFT).¹⁵³ The FATF was founded in July 1989 as a result of the Group of Seven (G-7) Summit in Paris, which was focused on the prevention of money laundering.¹⁵⁴ In October 2001, the FATF's objective was expanded to include the prevention of terrorist financing.¹⁵⁵ Notably, the International Monetary Fund (IMF) also conducts assessments based upon the FATF Recommendations.¹⁵⁶

An examination of the responsibilities and membership requirements of the FATF brings its crucial role into sharper focus. The primary responsibilities of the FATF are to monitor the implementation strategies of members, provide oversight of money laundering and terrorist financing regulations, and to encourage the enactment and implementation of similar measures in the international arena.¹⁵⁷ Through working with other international stakeholders, the FATF works to cure "national-level vulnerabilities."¹⁵⁸

The FATF currently has thirty-six members, including the U.S.¹⁵⁹ In addition, the European Commission is a member of the FATF and each of the EU Member States are also separate members.¹⁶⁰ In order to qualify for membership, a country must agree in writing to uphold the FATF's Forty Recommendations and its Nine Special Recommendations (collectively the FATF Recommendations) as well as the FATF AML/CFT Methodology 2004 (as amended).¹⁶¹ Each country also must agree to implement all FATF Recommendations

gafi.org/media/fatf/documents/reports/Combating_the_abuse_of_NPOs_Rec8.pdf.

153. *See id.*

154. FATF, *supra* note 110.

155. *See* FATF, FATF IX SPECIAL RECOMMENDATIONS 2 (2001), available at <http://www.fatf-gafi.org/media/fatf/documents/reports/FATF%20Standards%20-%20IX%20Special%20Recommendations%20and%20IN%20rc.pdf>.

156. FATF RECOMMENDATIONS, *supra* note 109, at 8.

157. *See generally id.* (proposing global recommendations to stop terrorists from obtaining funding).

158. *See* FATF, *supra* note 110.

159. *Members and Observers*, FATF, <http://www.fatf-gafi.org/pages/aboutus/membersandobservers/> (last visited Oct. 14, 2014).

160. *See id.*

161. *Members and Observers*, FATF, <http://www.fatf-gafi.org/pages/aboutus/membersandobservers/membershipprocessandcriteria.html> (last visited Oct. 14, 2014).

within a reasonable timeframe and to undergo a Mutual Evaluation during the process (based on AML/CFT criteria), and periodically after becoming a member.¹⁶² The FATF then releases a Mutual Evaluation Report (MER), which details the member's degree of compliance with the FATF's Recommendations.¹⁶³ The current ratings are as follows: Compliant, Largely Compliant, Partially Compliant, and Non-Compliant.¹⁶⁴ For purposes of this analysis, a country's rating under Special Recommendation VIII, now Recommendation 8 (R.8)¹⁶⁵ is the most relevant. The U.S. received a top rating of Compliant in its 2006 MER¹⁶⁶ whereas the U.K. received the rating just below of Largely Compliant.¹⁶⁷ Later, I will address the rating of the U.S. in comparison to that of Canada and Mexico,¹⁶⁸ both of whom the U.S. has reciprocity with in terms of charitable tax deductions under the terms of a bilateral treaty.¹⁶⁹ In essence, the FATF serves as an effective arbiter of how well a country is monitoring the use of charitable funds to ensure they do not end up in the hands of terrorists.

a. FATF Rules to Prevent Terrorist Financing Through Charities: Recommendation 8

The FATF rules designed to prevent terrorist financing through charities are based on R.8, which is one of the FATF's Forty-Nine

162. *See id.*

163. *See, e.g.*, FINANCIAL ACTION TASK FORCE, SUMMARY OF THE THIRD MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM: UNITED STATES OF AMERICA 12 (2006) [hereinafter THIRD U.S. MER SUMMARY], available at <http://www.fatf-gafi.org/media/fatf/documents/reports/mer/MER%20US%20ES.pdf>.

164. *See id.*

165. FATF BEST PRACTICES, *supra* note 152, at 3 n.3; George W. Sutton, *The New FATF Standards*, 4 GEO. MASON J. INT'L COM. LAW 68, 87 (2012).

166. THIRD U.S. MER SUMMARY, *supra* note 163, at 16.

167. FINANCIAL ACTION TASK FORCE, THIRD MUTUAL EVALUATION REPORT ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM: THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND 288 (2007) [hereinafter THIRD U.K. MER], available at <http://www.fatf-gafi.org/media/fatf/documents/reports/mer/MER%20UK%20FULL.pdf>.

168. *See infra* Part III.E.

169. *See* Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, U.S.-Mex., art. 22(2), Sept. 18, 1992, S. Treaty Doc. No. 103-7 [hereinafter Convention for the Avoidance of Double Taxation]; *see also* Convention with Respect to Taxes on Income and on Capital, U.S.-Can., art. XXI(5), Sept. 26, 1980, 1469 U.N.T.S. 189. The U.S. has a similar agreement with Israel. Pozen, *supra* note 112, at 540.

Recommendations.¹⁷⁰ In fact, the FATF has noted that it drafted R.8 because countries vary widely in their governmental measures designed to monitor the use of charitable funds, e.g., registration requirements, reporting, and recordkeeping.¹⁷¹ Terrorist organizations have used this lack of structure to infiltrate charitable organizations and to divert funds.¹⁷² R.8 is an attempt to regulate these procedures around the world. R.8 provides that countries should conduct a review of the “adequacy of laws and regulations” to ensure charities cannot be “misused by terrorist organizations: (i) to pose as legitimate entities; (ii) to exploit legitimate entities as conduits for terrorist financing, including for the purpose of escaping asset freezing measures; or (iii) to conceal or obscure the clandestine diversion of funds intended for legitimate purposes, but diverted for terrorist purposes.”¹⁷³

b. FATF Requirements: FATF Best Practices Paper and the Interpretive Note to Recommendation 8

The actions required to comply with R.8 are outlined in the FATF’s Best Practices paper on R.8 (the FATF Best Practices Paper),¹⁷⁴ in addition, the FATF has released an Interpretive Note to clarify the Recommendations (Interpretive Note to R.8).¹⁷⁵ The FATF’s Interpretive Note to R.8 goes on to identify specific measures for meeting its objectives.¹⁷⁶ Thus, the FATF Best Practices Paper and the Interpretive Note to R.8 (together, the FATF Requirements), combined with the use of existing terrorist lists, should satisfy the U.S. On a most basic level, the Interpretive Note to R.8 instructs countries to conduct a review of their charitable sector or to ensure there is another way to obtain information on the sector’s “activities, size and other relevant features.”¹⁷⁷ It also advises countries to use such information to

170. FATF RECOMMENDATIONS, *supra* note 109, at 7.

171. *Id.* at 54; *see* FATF BEST PRACTICES, *supra* note 152, at 3–4, 5.

172. FATF RECOMMENDATIONS, *supra* note 109, at 54.

173. *See id.* at 13, 54.

174. *Id.*

175. *See id.* at 8, 54–58 (the Interpretive Note to R.8 is incorporated in the FATF Recommendations).

176. *Id.* at 54–58

177. *Id.* at 55.

determine which charities are particularly vulnerable to terrorist abuse and to conduct regular re-assessments.¹⁷⁸

The Interpretive Note section entitled “Measures” goes on to elaborate upon four specific actions countries should take in light of four areas that form an effective approach to recognizing and avoiding terrorist abuse of charities: “(a) outreach to the sector, (b) supervision or monitoring, (c) effective investigation and information gathering and (d) effective mechanisms for international cooperation.”¹⁷⁹ In comparing the actions associated with each of these four elements, there are numerous similarities with the Treasury Department’s Revised Guidelines that confront anti-terrorist financing, as discussed later.¹⁸⁰ Again, these similarities lend credence to the argument that the U.S. should consider accepting the FATF’s rating of a country and its sector as valid and reliable. Perhaps of even greater significance are the actions associated with the fourth element dealing with international co-operation. Members of the FATF agree to maintain contact lists and procedures to assist with any other countries’ inquiries regarding suspect charities.¹⁸¹ In light of the FATF’s role and diligence in ensuring effective monitoring, the U.S. should be able to relinquish at least part of its monitoring tasks.

C. Fitting It All Together for Implementation in the U.S.

For purposes of this article, a basic premise is that the U.S. would recognize charities formed within certain EU Member States as eligible to receive U.S. tax deductible donations. The standardized charitable form proposed in the EU reflects a legal form that is easily amenable to current U.S. requirements as explained in Part II. The next section will show that the FATF requirements, subject to slight modification, and FATF ratings of countries provide a way for the U.S. to determine which EU countries have evinced acceptable precautions for ensuring funds do not end up as terrorist financing. Presumably,

178. FATF RECOMMENDATIONS, *supra* note 109, at 55.

179. *Id.*

180. *See infra* Part III.D.3.

181. FATF RECOMMENDATIONS, *supra* note 109, at 58.

the U.S. could begin with the U.K., given its pursuit of change, the current regulatory measures in place, and the FATF assessment of its compliance.¹⁸²

The actual mechanism to be used should likely be an IRS-approved list, as suggested in the first article of this series,¹⁸³ although alternative approaches are feasible.¹⁸⁴ If the U.S. consulted the registry the U.K. Charity Commission maintains and updated its own registry i.e., Exempt Organizations (EO) Select Check,¹⁸⁵ in light of an approval process, there would be an extra layer of supervision that would occur. This would encourage other nations to maintain registries with the hopes that other countries would reach similar agreements with them and make the charitable sector vastly more transparent. Perhaps over time, the U.S. and the U.K. would form a website where charities listed on both registries (assuming reciprocity were to occur) could be compiled, and information regarding such charities could be subjected to even greater scrutiny by donors, thereby promoting efficiency.¹⁸⁶

One point of contention relevant in terms of establishing an efficient charitable market is that charities are having to divert too much of their investments to complying with anti-terrorist measures; by deferring to the international bodies and other regulatory authorities of certain carefully chosen countries, the U.S. could reduce some of this cost and thereby contribute to greater efficiency overall.¹⁸⁷ In looking at not only the U.S.'s approach but also that of other countries in preventing the use of charitable organizations for terrorist financing, one must consider the extent to which greater regulation stifles the ability of charities to conduct their given purposes. A working group established to discuss revisions to the initial Treasury Department Guidelines and comprised of approximately thirty organizations, including private foundations, public charities, and religious organizations, and which

182. See *infra* Part III.F.

183. Johnson, *supra* note 2, at 85–86.

184. See Zolt, *supra* note 17, at 393–94.

185. *EO Select Check*, IRS, <http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Select-Check> (last updated Oct. 6, 2014).

186. See, *infra* Part III, for an exploration of the use of donor-advised funds. See also Johnson, *supra* note 2, at 85–86 (explaining donor-advised funds).

187. See Johnson, *supra* note 2, at 84–85.

represented thousands of organizations (the Working Group)¹⁸⁸ has noted that the cost of complying should be considered.¹⁸⁹ In addition, Professor Mark Sidel cautions against the negative impact such regulations may have and also suggests they might not be entirely necessary: “We must be vigilant in observing and ensuring that these new forms of regulation do not narrow the freedom of association and voluntary sector activities that are so important in some [sic] many countries around the world.”¹⁹⁰ A 2010 World Bank report also revealed the rarity of charitable funds being diverted to terrorist activity.¹⁹¹ This point reinforces the conclusion that the U.S. should consider deferring to the counter-terrorist regimes of other countries in the regulation of charitable organizations. The FATF recently revised its Recommendations with the aim of not placing stumbling blocks in the paths of charities carrying on legitimate activities.¹⁹² In the next section, I will consider other reasons why, with certain modifications, the FATF approach, like the Working Group’s approach, is a well-suited substitute to relying on the Revised Guidelines.

D. Comprehensive Analysis of Rules to Prevent Terrorist Financing Through Charities: U.S. Treasury Regulations (Revised Guidelines) v. FATF Requirements

If one considers why the Treasury Guidelines were revised, then it becomes clear that the FATF requirements, subject to slight modification, should be acceptable to the U.S. One should note that, unlike the FATF requirements, the Revised Guidelines are not compulsory.¹⁹³ In this section, I will explain why the Treasury Guidelines were revised to argue for U.S. acceptance of slightly

188. *See id.* at 84.

189. *See id.*; *see also* Sharon P. Light, *The Principles of International Charity: An Effective Alternative to the Voluntary Guidelines*, INT’L DATELINE (Council on Foundations, Arlington, Va.) First Quarter 2005, at 3.

190. MARK SIDEL, REGULATION OF THE VOLUNTARY SECTOR: FREEDOM AND SECURITY IN AN ERA OF UNCERTAINTY 134 (2010).

191. EMILE VAN DER DOES DE WILLEBOIS, NONPROFIT ORGANIZATIONS AND THE COMBATTING OF TERRORISM FINANCING: A PROPORTIONATE RESPONSE 5, 11–13, 19 (2010).

192. FATF RECOMMENDATIONS, *supra* note 109, at 55.

193. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. 63,838, 63,843 & n.1 (Oct. 31, 2006).

modified FATF requirements as a suitable substitute. To build upon that argument, I will set forth a comprehensive comparison of the Revised Guidelines and the FATF requirements and show that they are, in fact, similar. I will conclude that if a country subject to the FATF requirements, with a satisfactory FATF rating, agrees to the use of existing terrorist lists detailed in the Revised Guidelines, the U.S. should recognize its charities as able to accept U.S. tax deductible donations.

1. *The Need for a Simple Approach*

If one examines the report of the Working Group compiled in response to the 2002 Revised Guidelines, “Principles of International Charity” (the Principles), it is clear that a simple approach is what the charitable sector feels is the most appropriate response to terrorist concerns.¹⁹⁴ The FATF’s approach, detailed more fully later,¹⁹⁵ embodies the main tenets of the Principles and the desire to keep its standards simple for members. As a result, the FATF requirements, subject to the modification explained below, should satisfy the U.S.

The 2002 Guidelines were revised due in part because they were largely viewed as untenable.¹⁹⁶ In revising the Guidelines, the Treasury Department considered the Principles, which reflected the Working Group’s position as representatives of the charitable sector.¹⁹⁷ Chief among the Working Group’s concerns was simplicity.¹⁹⁸ The following four tenets were deemed the most important in preventing terrorist abuse of U.S. charities in the Principles: (1) charitable organizations must only carry out the charitable purposes for which they were formed, (2) charitable organizations must meet the charitable law standards of the U.S. and the relevant laws of foreign

194. TREASURY GUIDELINES WORKING GROUP, COUNCIL ON FOUNDATIONS, PRINCIPLES OF INTERNATIONAL CHARITY (2005); see Sharon P. Light, *The Principles of International Charity: An Effective Alternative to the Voluntary Guidelines*, INT’L DATELINE (Council on Founds., Arlington, Va.) First Quarter 2005, at 3. One reason for adopting a simple approach is to avoid the overuse of charitable funds for compliance. See FATF RECOMMENDATIONS, *supra* note 109, at 54–55.

195. FATF RECOMMENDATIONS, *supra* note 109, at 54–58.

196. Johnson, *supra* note 2, at 84.

197. *Id.*; see Anti-Terrorist Financing Guidelines, 71 Fed. Reg. 63,838, 63,840 (Oct. 31, 2006).

198. See Light, *supra* note 189, at 3.

jurisdictions in which they are carrying out their charitable purposes, (3) a charitable organization's compliance with relevant laws is the province of the board of directors, and (4) charitable organizations must ensure that appropriate steps are taken to ensure that their assets are used only for charitable purposes through the use of financial controls.¹⁹⁹

This straightforward approach provides charities with concrete direction without overburdening them. In their 2006 Revised Guidelines, the Treasury Department agreed with this approach with one caveat: Use of existing "lists of suspected or known supporters of terrorism" should be advocated.²⁰⁰

Similar to the Working Group's report, the FATF requirements (embodied in the Interpretive Note to R.8 and the FATF Best Practices Paper regarding R.8) utilize a simplified approach. In fact, in its Revised Guidelines, the Treasury Department recognized an FATF Best Practices Paper as providing guidance on the prevention of abuse of charities by terrorist organizations.²⁰¹ Thus, if the FATF requirements are modified to include the use of existing terrorist lists, an area the Treasury Department found deficient in terms of the Principles,²⁰² they look remarkably similar to the 2006 Revised Guidelines. As a result, the U.S. should view the FATF requirements as an acceptable substitute. An understanding of the basic purpose and principles of the non-compulsory, revised Treasury Guidelines also lends support to this position.

2. *U.S. Treasury Guidelines: Basic Purpose and Principles*

The Revised Guidelines provide non-compulsory safeguards for the prevention of terrorist financing,²⁰³ and the U.S. could make these guidelines compulsory for any non-U.S. charity eligible to collect U.S.

199. *Id.*

200. *Id.* at 5; Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63, 842, 63, 847.

201. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,848.

202. *See id.* at 63,846 n.11, 63,840; Kay Guinane, Summary of 2005 Revisions to U.S. Department of the Treasury's Anti-Terrorist Financing Guidelines, CENTER FOR EFFECTIVE GOV'T (Dec. 12, 2005), <http://dev.ombwatch.org/node/2712>.

203. *Id.* at 63,843 n.1.

funds as a way to safeguard against terrorist funding. However, this is an unnecessary step. As the following survey will show, the FATF requirements already reflect much of what is advised.²⁰⁴ Interestingly, the Treasury Department notes that its Revised Guidelines are not intended to supersede or modify the practices of charities with extensive experience in providing international aid and notes that many already have implemented “effective internal controls and practices that lessen the risk of terrorist financing or abuse.”²⁰⁵ Also, the Treasury Department acknowledges that emergency situations, specifically catastrophic disasters,²⁰⁶ may mean the Revised Guidelines are more difficult to apply in practice; this reality should influence which charities are placed on an IRS-approved list.²⁰⁷ One purpose of the Revised Guidelines is to increase awareness among donors and U.S. charities of the practices charities may put in place to decrease the risk that funds end up financing terrorist activity.²⁰⁸ Another stated purpose of the Revised Guidelines is to assist charities with understanding U.S. legal requirements in place to prevent terrorist financing, including sanctions programs associated with the Office of Foreign Assets Control (OFAC).²⁰⁹

There are four fundamental principles of good practice set forth in the Revised Guidelines:

- (1) Charities are required to comply with all laws of the U.S. Government, including OFAC-administered sanctions programs.²¹⁰

204. *See infra* Part III.D.3.

205. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,843.

206. *Id.*

207. *See generally* Eric Friedman, *Putting Your Charity Dollars Where They Matter Most*, L.A. TIMES, Jan. 31, 2014, at 19.

208. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,843.

209. *Id.*; *see, e.g.*, 18 U.S.C. § 2339A (2012) (prohibiting “material support or resources”); 18 U.S.C. § 2339C (2012) (prohibiting financing); *see also* Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,843 n.2 (detailing complete list of the federal criminal statutes pertaining to terrorist funding).

210. *See* Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,843& n.2 (“OFAC sanctions programs include those relating to particular countries or regimes (country-based programs), as well as those relating to groups, individuals, or entities engaged in specific activities”). Presumably, this standard would apply according to the home State law of the charity. Note that sanctions programs either forbid certain transactions, impose a U.S. block on assets and property, or both. *Id.*

- (2) Charities should adopt practices outside of the law to ensure assets are used only for charitable purposes or other legitimate purposes.²¹¹
- (3) Those individuals carrying out fiduciary responsibilities on behalf of the charity should evince due care. The Guidelines provide that such care should be exercised as defined under “applicable common law as well as local, state, and federal” law.²¹²
- (4) Every level of the charity and its operations must reflect “[g]overnance, fiscal and programmatic responsibility[,] and accountability”²¹³

These principles inform the more detailed instructions of the Revised Guidelines. As apparent from the section below, the FATF requirements evince a similar approach.²¹⁴ Following is a first comprehensive comparison of the Revised Guidelines and the FATF requirements. It starts with the fourth factor above, accountability and transparency, and next turns to two other topics: programmatic verification, i.e., preventing improper use of funds, and the responsibilities of the governing board. Finally, the comparison examines the Revised Guidelines’ anti-terrorist financing provisions, i.e., verification of grantees and employees, and the Interpretive Note to R.8, which is the overarching document informing the FATF Best Practices Paper.²¹⁵

3. Comparison of U.S. Treasury Guidelines with FATF Requirements

Because FATF members must commit to implementing the FATF’s requirements and to undergoing regular assessments of their compliance,²¹⁶ the U.S. can rely on the FATF’s monitoring.

211. *Id.* at 63,844.

212. *Id.* Presumably, this standard would apply according to the home State law of the charity.

213. *Id.*

214. *See infra* Part III.D.3.

215. *See generally* FATF BEST PRACTICES, *supra* note 152 (referring, throughout, to the FATF Recommendations Interpretive Note to R.8).

216. *Id.* at 6; FATF RECOMMENDATIONS, *supra* note 109, at 54.

Nevertheless, the U.S. should require use of existing terrorist lists in the way the Revised Guidelines advocate. In this section, I will set forth a comprehensive survey of the Revised Guidelines and the provisions of the FATF's requirements and conclude that they surprisingly encompass similar goals and methods. As a result, the FATF's requirements, if modified to include use of existing terrorist lists, and the FATF's ongoing assessment process provide adequate oversight.

a. Financial Accountability and Transparency

The methods presented in the FATF Best Practices Paper under "Financial Transparency" and the Revised Guidelines under "Financial Accountability and Transparency" mirror each other.²¹⁷ This lends credence to an argument that the U.S. may rely on FATF standards upheld in the FATF Best Practices Paper. The FATF Best Practices Paper emphasizes the use of full program budgets that detail expenses of the charity and include the identity of recipients as well as an explanation of how funds have been used; it also stresses the importance of independent auditing in order to retain donor confidence.²¹⁸ The Revised Guidelines provide for a near identical requirement, except that a threshold for the audit is included.²¹⁹ Specifically, the Revised Guidelines instruct charities to have in the place the following: an annual budget that the governing board has adopted, approved, and supervised; a board-appointed financial auditor responsible for daily control over the charity's assets; and for those charities whose annual gross income exceeds \$250,000, an annual publicly available audit from a board-selected independent certified public accounting firm.²²⁰ While the Revised Guidelines provide a slightly higher level of detail, overall the general admonition to charities is the same.

217. Compare FATF BEST PRACTICES, *supra* note 152, with Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,844.

218. FATF BEST PRACTICES, *supra* note 152, at 7.

219. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,841.

220. *Id.* at 63,844–45.

b. Receipt and Disbursement of Funds

The FATF Best Practices Paper includes a subsection on bank accounts under the “Financial Transparency” section,²²¹ and the Revised Guidelines address this issue under a subsection entitled “Receipt and Disbursement of Funds.”²²² Although the requirement under the FATF Best Practices Paper is much terser, essentially, the Revised Guidelines add only two other requirements: (1) compliance with generally accepted accounting principles and Code requirements and (2) maintenance of a record of salaries.²²³ Both the FATF and the Treasury Department urge charities to make disbursements through check or wire transfers rather than cash or currency disbursements.²²⁴ Finally, the Revised Guidelines include parameters for the solicitation for funds under this section,²²⁵ whereas the FATF Best Practices Paper addresses this issue under a separate “Solicitation” section.²²⁶ Most notably, the Revised Guidelines provide that the charity should state its intended goals and purposes for soliciting funds to foster an independent conclusion about whether the charity is complying with its goals.²²⁷ In addition, the Revised Guidelines note that solicitations should accurately inform donors of how their donations will be spent.²²⁸ If a charity decides to expend funds for another purpose, it should immediately and publicly disclose that fact.²²⁹ Similarly, the FATF Best Practices Paper states that charities should identify the purposes for which they are soliciting funds and ensure that such funds are used for stated purposes.²³⁰

The main difference between the two involves public disclosure. The Revised Guidelines are much more insistent upon revealing

221. FATF BEST PRACTICES, *supra* note 152, at 7.

222. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,845.

223. *Id.*

224. *Compare id.*, with FATF BEST PRACTICES, *supra* note 152, at 7 (stating that formal financial systems should be used for transactions and encouraging the bringing of charitable accounts within the formal banking system).

225. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,845.

226. FATF BEST PRACTICES, *supra* note 152, at 7.

227. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,845.

228. *Id.* (defining final solicitation requirement regarding substantiation of donations).

229. *Id.*

230. FATF BEST PRACTICES, *supra* note 152, at 7.

information to the public,²³¹ and the U.S. should require this of non-U.S. charities.²³² Also, the FATF does make its reports of compliance public.²³³ The Revised Guidelines consider various mechanisms for public disclosure. Clearly, one of the most crucial mechanisms is the annual report requirement. Charities are urged to file an annual report that is available to the public.²³⁴ The suggested form for the annual report is similar to the Form 990 and Form 990-PF that U.S. charities are already required to file.²³⁵ The Revised Guidelines also advocate permitting any member of the public to see the charity's financial statements, including its financial audit upon request.²³⁶ The FATF Best Practices Paper appears to support this action as well.²³⁷

c. Programmatic Verification

Programmatic Verification is a major category for both the FATF and the Revised Guidelines. Both use this section to reflect a concern for ensuring proper use of and preventing diversion of funds.²³⁸ Under this heading, the Revised Guidelines contain sub-headings on “Supplying Resources,” “Supplying Services,” and “Programmatic Review.”²³⁹ Under “Supplying Resources,” the Revised Guidelines state charities should ensure grantees have the ability to complete the goal for which the money was given and to safeguard against the resources ending up in the hands of terrorists.²⁴⁰ Secondly, they note a

231. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,845.

232. At the same time, one may argue that in an efficient charitable market only providers of sufficient information will continue to be funded. *See* discussion *supra* pp. 3–4.

233. *See, e.g.*, THIRD U.S. MER SUMMARY, *supra* note 163.

234. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,845.

235. *Id.* (noting that the report should contain a statement of the “charity’s purpose(s), programs, activities, tax exempt status, the structure and responsibility of the governing board of the charity, and financial information.”); *see, e.g.*, I.R.S. Form 990 (2013), *available at* <http://www.irs.gov/pub/irs-pdf/f990.pdf>.

236. *See* Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,845.

237. *See* FATF BEST PRACTICES, *supra* note 152, at 6 (“Transparency is in the interest of the donors, organisations, and authorities.”).

238. *Id.* at 7; Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,845.

239. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,845. The rules regarding “Supplying Resources” and “Programmatic Review” are very similar to the expenditure responsibility rules that govern private foundation grants. *See* Dale, *supra* note 112, at 680–84.

240. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,842.

written agreement should govern the terms of the grant.²⁴¹ The requirement of a written agreement between the grantee and the charity is a notable distinction in the Revised Guidelines.²⁴² Finally, the Revised Guidelines urge the charity to exercise oversight over the use of funds during the term of the grant and to terminate the relationship should abuse occur.²⁴³

The FATF Best Practices Paper confronts the same issues through asking charities to conduct an assessment using the following four direct questions: “Have projects actually been carried out? Are the beneficiaries real? Have the intended beneficiaries received the funds that were sent for them? Are all funds, assets, and premises accounted for?”²⁴⁴

These questions parallel the Revised Guidelines, which provide that grantees should file periodic reports on their operations and disbursed funds, and grantees should take reasonable steps to ensure funds are not diverted to terrorist activity (of which the charities should be advised).²⁴⁵ The Revised Guidelines indicate charities should carry out “routine, on-site audits of grantees to the extent reasonable.”²⁴⁶ Again, most of these precautions follow logically from the above-mentioned questions associated with the “Oversight” section of the FATF Best Practices Paper.²⁴⁷ The FATF Best Practices Paper recommends that charities conduct direct field examinations as needed to ensure funds are being expended for the agreed upon purposes.²⁴⁸

Inter-government collaboration is a hallmark of the FATF Best Practices Paper that the U.S. should adopt. Notably different from the Revised Guidelines, the FATF Best Practices Paper identifies the need for cooperation between countries when the charity’s home office is in a country different from where its charitable work is being performed,

241. *Id.* at 63,845.

242. *See id.*

243. *Id.* The Revised Guidelines also detail similar suggestions regarding “Supplying Services.” *Id.*

244. FATF BEST PRACTICES, *supra* note 152, at 7–8.

245. *Compare id.*, with Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,845.

246. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,845.

247. FATF BEST PRACTICES, *supra* note 152, at 7–8.

248. *Id.* at 8.

under the section, “Foreign Operations.”²⁴⁹ The U.S. should also encourage collaboration in these instances, as well. Clearly, having two countries monitor the effectiveness of charities is preferable from many standpoints.

d. Responsibilities of the Board

Both the Revised Guidelines and the FATF Best Practices Paper place primary responsibility with preventing terrorism financing, i.e., accountability and transparency, with the governing board.²⁵⁰ Accordingly, each sets forth board requirements,²⁵¹ and a comparison reveals they are remarkably similar. The Revised Guidelines clearly state the functions and parameters of the board. The following is a summary of the seven requirements:

- (1) Board members should not be involved with the “day-to-day management” of the charity, and the charity should have a conflict of interest policy in place for all board members and employees. (The conflict of interest policy should delineate procedures applicable if a board member or employee has a conflict of interest or a perceived conflict of interest in terms of managing or operating the charity).²⁵²
- (2) The board’s responsibilities are to ensure compliance with relevant laws, to maintain the charity’s finances and accounting practices through adopting, implementing, and overseeing such practices, including financial recordkeeping designed to safeguard assets.²⁵³

249. *Id.*

250. *Compare id.*, with Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,844.

251. FATF BEST PRACTICES, *supra* note 152, at 8–9; Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,844. The Revised Guidelines go on to set forth principles for key employees, defined not only as the most highly compensated employees but also as any employees involved in the disbursement of funds. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,844 n.7. The Revised Guidelines state charities should maintain a list of their five most highly compensated employees, identifying information for any key, non-U.S. employees working abroad, and identifying information, subject to privacy rights, for any key employees of subsidiaries or affiliates. *Id.* at 63,844.

252. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,844.

253. *Id.*

- (3) The board should keep records of its decisions.²⁵⁴
- (4) A list of the names, salaries, and relevant affiliations of all board members should be maintained and made available to the public.²⁵⁵
- (5) Within the confines of individual privacy rights, charities should have records of certain additional information about the board, including their home address, citizenship, etc.²⁵⁶
- (6) Subject to the same restriction as above, the charity should have the aforementioned information for the boards of any subsidiaries or affiliates receiving their charitable funds.²⁵⁷
- (7) In the event of being served with process or when there is other “appropriate authorization,” the charity should deliver records required under the Guidelines to regulatory/supervisory and law enforcement authorities without delay.²⁵⁸

Of these requirements, all are reflected in the FATF’s Best Practices Paper, except for the first, conflict of interest policy, and the last two, subsidiary level application and response to service of process.²⁵⁹ In terms of modification of the FATF approach, the U.S. should view it as crucial that a conflict of interest policy detailed in the first requirement is in place.²⁶⁰ The sixth requirement adds another level of scrutiny, which is only suggested in the FATF Best Practices Paper.²⁶¹ Finally, requirement seven is also implied, but not expressly provided for in the FATF Best Practices Paper.²⁶² Even if a charity only complied with the four requirements of the FATF Best Practices Paper,

254. *Id.*

255. *Id.*

256. *Id.*

257. *Id.*

258. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,844.

259. FATF BEST PRACTICES, *supra* note 152, at 9.

260. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,844.

261. FATF BEST PRACTICES, *supra* note 152, at 8.

262. *Id.* at 10.

plus the conflict of interest policy, there should be sufficient precautions in place to prevent the diversion of funds.

e. Anti-Terrorist Financing Best Practices

The last section of the Revised Guidelines, “Anti-Terrorist Financing Best Practices,” in addition to the Interpretive Note to R.8 most closely resembles the course of action suggested. Under “Measures,” the Interpretive Note to R.8 details actions FATF countries should take to form an effective approach to recognizing and avoiding terrorist abuse of charities: “(a) outreach to the sector, (b) supervision or monitoring, (c) effective investigation and information gathering and (d) effective mechanisms for international cooperation.”²⁶³ The “supervision or monitoring” measure closely shadows, albeit on a more macro level, Part VI of the Revised Guidelines on anti-terrorist financing.²⁶⁴ This “supervision or monitoring” measure provides:

[Charities] should follow a “know your beneficiaries and associate [charities]” rule, which means that the [charity] should make best efforts to confirm the identity, credentials and good standing of their beneficiaries and associate [charities]. [Charities] should also undertake best efforts to document the identity of their significant donors and to respect donor confidentiality.²⁶⁵

In contrast, the Revised Guidelines detail steps a charity should consider undertaking before deciding to make any grants.²⁶⁶ Importantly, the Revised Guidelines emphasize that all steps are not necessary and advocate a risk-based approach, particularly in regard to foreign grantees.²⁶⁷ According to the Revised Guidelines, charities should consider collecting the following information about grantees:

263. FATF RECOMMENDATIONS, *supra* note 109, at 55–56.

264. *Compare id.* at 56–57, with Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,845–46.

265. FATF RECOMMENDATIONS, *supra* note 109, at 57.

266. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,845–46.

267. *Id.* at 63,845–46.

- (1) their name (which seems obvious), language spoken in home country, and any acronym or other name the grantee uses;
- (2) the relevant jurisdictions where the charity has a physical presence;
- (3) historical information that would confirm the grantee's "identity and integrity" such as its place of incorporation; its incorporation documents and governing instruments; the name of the incorporator and the names of those who operate it; and information about its operating history;
- (4) identifying information about the place(s) of business of the charity;
- (5) a statement of the general purpose of the charity;
- (6) identifying information for the "individuals, entities, and organizations to which the grantee currently provides or proposes to provide funding, services, or material support, to the extent reasonably discoverable;"
- (7) identifying information for subcontracting organizations the grantee uses;
- (8) any "public filings or releases," including any annual reports, essentially those equivalent to the Form 990 or Form 990-PF; and
- (9) a list of additional sources of income as well as commercial activities.²⁶⁸

In sum, the Revised Guidelines set forth an overview of the basic steps a charity should take to prevent terrorist financing. Additionally, the Revised Guidelines offer a procedure for "vetting" grantees.²⁶⁹ The Revised Guidelines separate this process into vetting of grantees and vetting of the charities' key employees.²⁷⁰ The main recommendation is to "conduct a reasonable search of publicly available information" to determine whether there has been any question of a grantee engaging in terrorist activity, including terrorist financing.²⁷¹

268. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,846.

269. *Id.*

270. *Id.* at 63,486–87.

271. *Id.*

Accordingly, the Revised Guidelines state plainly that charities should avoid conducting transactions with a grantee where such “terrorist-related suspicions exist.”²⁷² The Revised Guidelines do not seem to add requirements to the Interpretive Note to R.8, but rather merely expand upon specific steps that may be taken to “know your [grantees] and associate [charities].”²⁷³

Both the FATF Best Practices Paper and the Revised Guidelines encourage charities to utilize not only tax authorities but also other law enforcement authorities and regulatory authorities in preventing terrorist financing.²⁷⁴ The FATF Best Practices Paper advocates drawing upon the expertise of the financial sector in investigating possible terrorist connections.²⁷⁵ Information sharing among such bodies is encouraged in both as well.²⁷⁶ The FATF Best Practices Paper also states that private watchdog organizations may prove beneficial,²⁷⁷ which is a resource that should play a larger role in the U.S. monitoring and perceived monitoring assessment of other countries.²⁷⁸

In contrast to the FATF requirements, the Revised Guidelines identify specific U.S. lists that should be used to gather information about grantees.²⁷⁹ The U.S. should require any non-U.S. charity to attest to verifying grantees against these lists, as well, especially where other UN Member States are involved. First, in terms of the lists that should be used in conducting the search, the Revised Guidelines recommend the Terrorist Exclusion List (TEL).²⁸⁰ The TEL is a result

272. *Id.* at 63,847.

273. FATF RECOMMENDATIONS, *supra* note 109, at 57.

274. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,844; FATF BEST PRACTICES, *supra* note 152, at 9, 10. These concerns are also described in the Interpretive Note to R.8 under the measure on effective information gathering and investigation. FATF RECOMMENDATIONS, *supra* note 109, at 57–58.

275. FATF BEST PRACTICES, *supra* note 152, at 10–11.

276. *See* FATF RECOMMENDATIONS, *supra* note 109, at 57; *see* Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,847.

277. FATF BEST PRACTICES, *supra* note 152, at 11.

278. Current private sector monitors of U.S. charities include Guidestar, Council on Foundations, and The National Council on Charitable Statistics. *See About*, NCCS, nccs.urban.org/about/index.cfm (last visited Oct. 17, 2014). *Cf.* Gallagher, *supra* note 104 (recommending Guidestar’s donor list as a method to validate grantees).

279. *Compare* Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,846, *with* FATF BEST PRACTICES, *supra* note 152, at 11.

280. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,846 n.11.

of the Patriot Act and permits the Secretary of State to include groups after consulting with or at the request of the Attorney General.²⁸¹ The notes to the Revised Guidelines explain that there is an overlap between the list of Specially Designated Nationals that OFAC maintains (the SDN List) and the TEL, but in comparison, the SDN list is under inclusive.²⁸² Second, even though the SDN list is under inclusive, the Revised Guidelines advise charities to check that a given grantee is not on the OFAC SDN list and has not been sanctioned by OFAC.²⁸³ Since the SDN List is available in different formats, charities will be able to search grantees easily according to “program, by country of residency, individuals vs. entities,” etc. in conducting risk-based research.²⁸⁴ Third, charities are urged to ensure that key employees, board members, and “other senior management at a grantee’s principal place of business, and for key employees at . . . other business locations”²⁸⁵ are fully identified and that such individuals are not subject to OFAC sanctions.²⁸⁶ Fourth, charities should consult other countries’ equivalent of these lists of “designated terrorist-related individuals, entities, or organizations” that are maintained in compliance with the United Nations Security Council Resolution 1373 (2001) (UNSCR 1373).²⁸⁷ UNSCR 1373 was adopted on September 28, 2001 and directs UN Member States to implement measures to prevent terrorism.²⁸⁸ Most relevantly, the UN Member

281. *Id.*

282. *Id.* The notes specify that U.S. persons may not provide services or conduct transactions with individuals designated on this list and stating that a block has been entered on their assets. *Id.* at 63,846 n.12.

283. *Id.* at 63,846 & n.11.

284. *See id.* at 63,846 n.12.

285. *Id.* at 63,846.

286. *See* Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,846–47 (stating that full identification means their full name in English, native language, any acronym or aliases used, nationality, citizenship, residence country, and birth date and location).

287. *Id.* at 63,847. Pursuant to United Nations Security Council Resolution 1373 (2001) (UNSCR 1373), UN Member States must freeze the funds and assets of any persons providing financial assistance or other support to “terrorist activity or terrorist-related individuals, entities, or organizations” and stating UN Member States must maintain a list of sanctioned parties. *Id.* at 63,847 n.14 (citing S.C. Res. 1373, U.N. Doc. S/RES/1373 (Sept. 28, 2001)).

288. S.C. Res. 1373, U.N. Doc. S/RES/1373 (Sept. 28, 2001).

States are called upon to criminalize acts of terrorism and to “work together . . . to prevent and suppress terrorist acts.”²⁸⁹

The Security Council’s Counter-Terrorism Committee (CTC) monitors compliance with UNSCR 1373²⁹⁰ and UNSCR 1624 (2005), a second resolution designed to criminalize the incitement of acts of terrorism.²⁹¹ As part of its efforts, the CTC requested that each country submit a report on the measures it has taken to prevent terrorism.²⁹² Experts have commented that the CTC maintains “the world’s largest body of information on the counter-terrorism capacity of each of the 192 UN Member States.”²⁹³ Interestingly, one of the reasons the Revised Guidelines encourage charities operating abroad to consider using the foreign UNSCR 1373 lists as part of “additional precautionary measures” is because doing so could help prevent the charity from being subject to sanctions or other penalties for failing to comply with foreign law.²⁹⁴ Additionally, the Revised Guidelines recommend checking the board and key employees of foreign grantees against this list as an additional safeguard measure.²⁹⁵ Foreign countries part of the UN will seek to impose sanctions on any individual, entity, or organization participating in terrorist support or financing.²⁹⁶

Additionally, with regard to the grantee and its individual members (i.e., key employees, board members, and other senior management), charities should consult “publicly available information” to determine whether they are “reasonably suspected” of terrorist activity, including funding.²⁹⁷ Finally, a pre-requisite for any grantee receiving funding from a charity should be a signed certification that it has complied with

289. *Id.*

290. *Id.*

291. S.C. Res. 1624, U.N. Doc. S/RES/1624 (Sept. 14, 2005).

292. *See id.* ¶ 5.

293. *Country Reports*, SECURITY COUNCIL COUNTER-TERRORISM COMMITTEE, <http://www.un.org/en/sc/ctc/resources/countryreports.html> (last updated Jan. 30, 2012); *see* DAVID CORTRIGHT, A CRITICAL EVALUATION OF THE UN COUNTER-TERRORISM PROGRAM: ACCOMPLISHMENTS AND CHALLENGES 5 & n.12 (2005) (describing the number of reports submitted by member states and their effect on the CTC’s knowledge of counter-terrorism efforts).

294. Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,847 n.14.

295. *Id.* at 63,847.

296. *See id.*

297. *Id.*

all U.S. laws that prohibit U.S. persons from conducting affairs with any individual, entities, or organizations upon which OFAC sanctions have been imposed or with foreign grantees, that they do not conduct transactions with known terrorist supporters or violators of OFAC sanctions.²⁹⁸

In terms of vetting its own key employees, charities are advised to take similar steps.²⁹⁹ Again, a “reasonable search of publicly available information” for key employees and potential employees should be conducted to ensure a lack of participation with terrorist activity or support.³⁰⁰ Likewise, the charity should ensure that its key employees have not been assessed or have infringed OFAC sanctions.³⁰¹ The Revised Guidelines detail the proper responses in the event the charity finds any of its own key employees, board members, senior management, or those of its grantees or the grantees themselves have a questionable tie to terrorist activity, including funding or support.³⁰² If the charity finds any of the above mentioned parties on the SDN List, it should exercise due diligence in accordance with the procedures set forth on the OFAC website.³⁰³ If the charity does not find a connection on the SDN List but finds questionable terrorist activity, it should report this information through a referral form that is accessible on the Treasury Department’s website.³⁰⁴ Also, this information may be reported to Federal Bureau of Investigation (FBI) local field offices.³⁰⁵ Accordingly, the U.S. should require any eligible non-U.S. charity to report such findings not only to the FBI but also to its governmental authorities.³⁰⁶ The point is not only to prevent diversion of funds but also to ensure reporting to relevant authorities.

298. *Id.*

299. *Id.*

300. *See* Anti-Terrorist Financing Guidelines, 71 Fed. Reg. at 63,847.

301. *Id.*

302. *Id.*

303. *Id.*

304. *Id.*

305. *Id.*

306. *Cf.* FATF BEST PRACTICES, *supra* note 152, at 5, 9–10 (encouraging transparency and cooperation between charities and their appropriate governing bodies, as well as accountability of charities to the appropriate authorities).

In comparing the methods of the FATF requirements with the Revised Guidelines, there are numerous similarities. These commonalities lend credence to the argument that the U.S. should accept the FATF's rating of a country's charitable oversight under R.8 as valid and reliable. Perhaps of even greater significance are the actions associated with the fourth element, i.e., international cooperation. In light of the FATF's role and diligence in ensuring effective monitoring, the U.S. should be able to relinquish at least part of its monitoring tasks, subject to certain modifications, particularly the use of lists in vetting grantees.

E. Current Inconsistent U.S. Stance

One of the most disturbing aspects of the current regulation is that the U.S. allows donors to make tax deductible contributions to charities in other countries through bilateral treaty provisions, despite their low FATF ratings.³⁰⁷ This section will involve an examination of two of the three countries the U.S. has entered into bilateral treaties with that allow U.S. deductions for contributions to their charities. Under Article XXI(5) of the U.S.-Canada Income Tax Treaty, a U.S. citizen or resident may receive a U.S. tax deduction for a donation to certain Canadian charities that are (1) treated essentially as a charity in Canada and (2) would be treated as a charity if formed in the U.S.³⁰⁸ A similar provision applies under Article 22(2) of the U.S.-Mexico Income Tax Treaty.³⁰⁹ Both Canada and Mexico have received unsatisfactory MERs in regard to R.8.³¹⁰ They are falling short of other countries, such as the U.K., in terms of anti-terrorist financing prevention.³¹¹ The U.S. should allow charities formed in other

307. See *supra* Part III.B.2.

308. Convention with Respect to Taxes on Income and on Capital, *supra* note 169.

309. See Convention for the Avoidance of Double Taxation, *supra* note 169.

310. FINANCIAL ACTION TASK FORCE, THIRD MUTUAL EVALUATION ON ANTI-MONEY LAUNDERING AND COMBATTING THE FINANCING OF TERRORISM-CANADA 254-59, 300 (2008) [hereinafter THIRD CANADA MER], available at <http://www.fatf-gafi.org/media/fatf/documents/reports/mer/MER%20Canada%20full.pdf>; FINANCIAL ACTION TASK FORCE, MUTUAL EVALUATION ON ANTI-MONEY LAUNDERING AND COMBATTING THE FINANCING OF TERRORISM-MEXICO 261-62, 324 (2008) [hereinafter MEXICO MER], available at <http://www.fatf-gafi.org/media/fatf/documents/reports/mer/MER%20Mexico%20ful.pdf>.

311. Compare THIRD CANADA MER, *supra* note 310, at 300, and MEXICO MER, *supra* note 310, at

countries (that have more favorable FATF ratings) to enjoy the same treatment as these less FATF compliant countries. The U.S. should adopt a more logical standpoint and rely on FATF assessments in allowing U.S. donors more flexibility in investing abroad.

1. *FATF Rating of Canada*

As mentioned above, under the terms of the U.S.-Canada Treaty, a U.S. donor may receive a tax deduction for a contribution to certain Canadian charities.³¹² Nevertheless, in its 2008 MER, Canada was found to be only Largely Compliant with Recommendation 8 (formerly SR.VIII).³¹³ The report noted this rating was based on Canada's failure to put in place "co-ordination mechanisms between competent authorities, especially between the [Canada Revenue Agency] and the parties responsible for listing and freezing applications."³¹⁴ This failure and its effect on this ranking meant that Canada was not taking sufficient precautions against the risk of terrorist financing through its nonprofit sector.³¹⁵ Even after six follow-up MERs, it does not appear that Canada has revised its laws in a manner that takes account of this concern.³¹⁶

2. *FATF Rating of Mexico*

Similarly, Mexico's 2008 MER stated it had failed to meet the basic requirement of R.8 (formerly SR. VIII): to conduct a review of its laws and regulations governing nonprofit organizations to determine their adequacy in respect to preventing terrorist financing.³¹⁷ Moreover, it did not have mechanisms in place to obtain information regarding its nonprofit sector or their "activities, size[,] and other relevant features"

324. *with* THIRD U.K. MER, *supra* note 167, at 288. Although the U.K. was given the same ranking as Canada, the U.K. was deficient only within Northern Ireland, as explained *infra* Part III.F.

312. Convention with Respect to Taxes on Income and on Capital, *supra* note 169.

313. THIRD CANADA MER, *supra* note 310, at 259, 300.

314. *Id.* at 259.

315. *See id.*

316. *See* FATF, SIXTH FOLLOW-UP REPORT MUTUAL EVALUATION OF CANADA (2014) (commenting on Canada's updated laws to achieve compliance without mention of R.8), available at www.fatf-gafi.org/media/fatf/documents/reports/met/FUR-Canada-2014.pdf.

317. *See* THIRD MEXICO MER, *supra* note 310, at 256, 261–62.

to better understand which organizations were likely to be at risk for a misdirection of funds to terrorist activity.³¹⁸ Overall, Mexico received a rating of Partially Compliant, which is lower than the ratings of both the U.S. and Canada.³¹⁹ The other deficiencies recorded in Mexico's report include the following: (1) the failure to raise awareness or to suggest precautions to prevent charitable funds from being used as terrorist financing, and (2) the failure to put in place investigative measures to make a determination of charities which either are being misused in or actively involved in terrorist financing.³²⁰

F. *Going Forward—U.S. Approach*

It would be an easy stretch for the U.S. to recognize U.K. charities, and perhaps even those of other EU Member States, as having comparable oversight to U.S. charities and therefore to allow U.S. donors to receive deductions for contributions made to them. The U.K.'s regulation of its sector in some ways vastly exceeds the regulation present in the U.S. In its most recent MER, the U.K. received, in terms of R.8 (formerly SR.VIII), the same rating of Largely Compliant as Canada did, which is just one mark lower than the U.S. received.³²¹ However, unlike Canada's rating, the U.K.'s rating was based on the absence of a system for providing for registration, transparency, and supervision of charities formed in a certain part of it, namely Northern Ireland.³²² In other words, the charities associated with the rest of the U.K. were deemed to have met the standards associated with R.8. If the U.S. chose to acknowledge U.K. charities as valid vehicles for the contribution of U.S. charitable funds, it could exclude charities in Northern Ireland until the issue is remedied. To not allow deductible contributions to U.K. charities, which are in form similar to, and at times more effective than, U.S. charities leads to a more ineffective charitable market. Furthermore,

318. *Id.* at 256, 261.

319. Compare THIRD U.S. MER SUMMARY, *supra* note 163, at 16, and THIRD CANADA MER, *supra* note 310, at 259, 300, with MEXICO MER, *supra* note 310, at 262, 324.

320. MEXICO MER, *supra* note 310, at 261–62, 336–37.

321. THIRD U.K. MER, *supra* note 167, at 288; THIRD U.S. MER SUMMARY, *supra* note 163, at 16.

322. THIRD U.K. MER, *supra* note 167, at 288.

the IMF's findings on countries' compliance with FATF Recommendations from 2004-2011, evinced that the U.K. ranked higher (35.33) than the U.S. (34.33) in terms of overall compliance.³²³ Interestingly, even though Canada and the U.K. received a rating of Largely Compliant on their respective MERs, Canada's overall IMF score (25) was significantly lower than the U.K.'s.³²⁴ Mexico's overall score (24.67) was even lower than Canada's.³²⁵ A comprehensive approach whereby the U.S. examines the rating of a country in terms of R.8 and its overall IMF rating could be used to determine which countries' charities are eligible to receive U.S. tax deductible contributions. Given the procedures that would need to be put in place for such an agreement to be made, the U.S. may prefer only to extend this treatment to EU Member States who have received a rating of at least Largely Compliant in terms of R.8 and a minimum overall IMF rating equal to at least that of the U.S., which currently is 34.33. An examination of the rigorous approach associated with the FATF's rating system and the IMF's findings lends credence to this thought.

CONCLUSION: THE PATHWAY TO CHANGE

To create an efficient charitable market, the U.S. must unshackle the hands of the giver to enable greater ease in cross-border charitable giving. As this article has shown, there are solutions to the problems associated with changing the law in this regard. First, there is a way to ensure that the floodgates are not opened too widely for U.S. investment in non-U.S. charities. The U.S. should define the range of acceptable charitable purposes based upon pressing, agreed-upon goals that foster global good. The UN Millennium Development Goals represent such aims.³²⁶ Moreover, as expert economists and advisers have noted, funding for the UN MDGs has been deficient, and the U.S.

323. Concepcion Verdugo Yepes, *Compliance with the AML/CFT Standard: Lessons from a Cross-Country Analysis* 39 (Int'l Monetary Fund, Working Paper No. 11/177, 2011). The U.S. was ranked as such in 2005 and the U.K. was ranked in 2006; neither was ranked more recently for the purposes of this evaluation. *See id.* at 39, 42.

324. *See id.* at 39.

325. *See id.*

326. *See supra* Part I.A.

may assist with correcting it through declaring the UN MDGs acceptable charitable purposes for eligible non-U.S. charities.³²⁷ Second, the U.S. must provide a standardized charitable form for such non-U.S. charities, so they will have certainty in terms of receiving a U.S. stamp of approval. A standardized charitable form will cut down on inefficient spending to meet tax and administrative requirements specific to the U.S.³²⁸ The EU standardized charitable form proposed for EU Member States in 2012 (i.e., the FE Statute) is instructive and may be modified to fit U.S. standards.³²⁹ Following this reasoning, charities formed under the FE Statute, with the appropriate modifications, should be acceptable to the U.S.³³⁰ Finally, the U.S. may ensure that unshackled investment does not end up financing terrorism. Contrary to conventional thinking, the IRS has done an inadequate job of monitoring the financing activity of U.S. charities,³³¹ and a U.S. decision to relinquish some of its monitoring (in the context of non-U.S. charities) would lead to more collaborative oversight throughout the global charitable sector. The FATF serves as a premier global monitor of its member countries' ability to prevent terrorist financing.³³² Accordingly, the U.S. may rely on its requirements, subject to modifications, and its ratings of various countries' compliance.

There is every reason to believe that a modified version of the existing FATF requirements could be applied to non-U.S. charities with satisfactory FATF ratings and proper form. These non-U.S. charities then could be placed on an IRS foreign donor list entitling donors to them to receive a U.S. tax deduction.³³³ The U.S. should start with U.K. and other EU charities (formed under the terms of the FE statute and with high FATF ratings) and require modification as outlined.³³⁴ The U.S. has the opportunity to take a historic lead in

327. *See supra* Part I.B.

328. *See supra* Part II.

329. *See supra* Part II.

330. *See supra* Part II.

331. *See supra* Part III.A.

332. *See supra* Part III.B.

333. *See* Johnson, *supra* note 2, at 85–86.

334. *See supra* Part III.C–D.

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establishing an efficient charitable market and in doing so help to alleviate some of the most urgent global ills in the process. Once the hands of givers are unshackled through a change in U.S. cross-border giving law, the U.S. may direct, guide, and protect such investment to ensure it ends up in the best place possible, in its most productive use for humanity and the world.

