

*new york state society of*

# NYSSCPA

*certified public accountants*

530 fifth avenue, new york, ny 10036-5101  
www.nysscpa.org

July 17, 2003

Mr. Robert Fontenrose  
Internal Revenue Service  
Attn: T:EO:RA:G (Announcement 2003-29)  
P.O. Box 7604  
Ben Franklin Station  
Washington, DC 20044

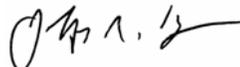
via e-mail to: Tege.eo2@irs.gov

Dear Mr. Fontenrose:

The New York State Society of Certified Public Accountants (NYSSCPA), the oldest state accounting association representing approximately 30,000 CPAs, is pleased to respond to the IRS's request for comments regarding clarifications to existing requirements that section 501(c)(3) organizations must meet with respect to international grant-making and other international activities.

The NYSSCPA Exempt Organizations Committee drafted the attached comments. Members of the committee would be pleased to meet with you for additional discussion about the comments. Please contact Martin S. Cantor, chair of the committee, at (212) 840-3456 or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303 if such discussions would be helpful.

Sincerely,



Jeffrey R. Hoops  
President

Attachment

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**NEW YORK STATE SOCIETY OF CERTIFIED PUBLIC  
ACCOUNTANTS**

**COMMENTS PURSUANT TO INTERNAL REVENUE SERVICE  
ANNOUNCEMENT 2003-29**

**CONSIDERING FURTHER GUIDANCE ON HOW CHARITABLE  
GROUPS CAN MEET INTERNAL REVENUE CODE SECTION  
501(c)(3) REQUIREMENTS WITH REGARD TO VARIOUS  
INTERNATIONAL GRANT-MAKING ACTIVITIES**

**JULY 17, 2003**

**Principal Drafters**

**Paul E. Hammerschmidt, CPA  
Martin S. Cantor, CPA  
Brian P. Wheeler, JD  
Brian N. Raeter, CPA**

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## NYSSCPA Staff

Ernest J. Markezin

**NEW YORK STATE SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS**

**COMMENTS PURSUANT TO INTERNAL REVENUE SERVICE  
ANNOUNCEMENT 2003-29: CONSIDERING FURTHER GUIDANCE ON HOW  
CHARITABLE GROUPS CAN MEET INTERNAL REVENUE CODE SECTION  
501(C)(3) REQUIREMENTS WITH REGARD TO VARIOUS INTERNATIONAL  
GRANT-MAKING ACTIVITIES**

**July 17, 2003**

The NYSSCPA supports modifications to Form 990 that would capture additional details about foreign charitable grants and recommends an education campaign to raise awareness that would stop unintentional funding of terrorists. See the recommendations following the general statement additional details.

An impediment to the federal government and IRS's enforcement of anti-terrorism funding legislation is difficulty in obtaining accurate factual information to identify charities funding terrorism, either directly or indirectly. The task is even more difficult without the assistance of the charitable community. The goal should be for each charity to ensure that its funds are being used solely for charitable purposes. To the extent each charity takes a proactive role, the charitable community can further the fight against terrorism and prevent the funding of terrorists.

**Background**

Since the horrific terrorist attacks against the United States on September 11, 2001, the subsequent news coverage includes many anecdotes of public charities and private foundations that have used the donations of well-intentioned donors to fund terrorist activities. On occasion, reports indicate that the diversion of funds may not have occurred until the money had been "laundered" through several presumably well-intentioned charitable entities.

The news has also reported stories about the humanitarian needs around the world. Therefore, there are incentives and needs for U.S. charities to continue to support overseas relief organizations. At the same time, however, such support must not be diverted to purposes inconsistent with an organization's charitable exempt purpose under Internal Revenue Code ("Code") section 501(c)(3).

The charitable community needs to be given the tools to enable it to do its part in combating terrorism. Nonprofits cannot rely solely upon the federal government to police this area: the nonprofits themselves, with the help of their financial advisors, must become active players in the fight against terrorism.

Nonprofits should monitor their own support of overseas activities. It is incumbent upon the nonprofit community to provide oversight both to ensure that each charity's purpose is being fulfilled (consistent with existing law) and to assure well-meaning donors that their funds are being utilized for humanitarian needs, and not for terrorism. Donors should demand nothing less from the entities for which they provide support.

In response to the events of September 11<sup>th</sup>, and in an effort to protect the United States and Americans from international terrorism, various measures have been enacted by the U.S. Government with broad implications for international grantmaking. The following is a summary of U.S. and international legislation and groups involved in countering the financing of terrorist organizations:

#### U.S. Executive Order 13224, signed Sept. 24, 2001

The executive order calls for the compilation and maintenance of a list of all those “associated with” designated terrorist groups. It expands upon previous executive orders to include those involved in any acts of global terrorism, not just those committed in the Middle East or by the Taliban. The order explicitly targets those involved in any aspect of terrorist financing, including fundraisers, donors, transfer agents, charitable organizations and banks. The people or entities placed on the list are labeled Specially Designated Global Terrorists (SDGTs).

The Treasury Department has the authority, under the executive order, to freeze all U.S. assets and to block any U.S. transactions of the SDGTs. Treasury also has the power to block foreign banks and other financial institutions from access to U.S. markets and assets if they refuse to freeze the holdings of these specified terrorists.

#### Operation Green Quest (U.S.), established Oct. 25, 2001

Operation Green Quest is an inter-agency task force made up of the best financial investigators from the U.S. Customs Service, the IRS, the FBI, and the Secret Service. The group focuses on domestic underground financial systems, illicit charities, and corrupt financial institutions that may be sources of terrorist funding. In addition, Operation Green Quest investigators also attempt to root out potential future funding sources that have yet to be exploited by terrorists.

## USA PATRIOT Act, signed Oct. 26, 2001

Under this act, private financial institutions are asked to enhance transaction transparency, to search for a common customer identification system, and to find ways to prevent their financial services from being used for money laundering or the funding of terrorism. In addition to promoting greater cooperation between the government and the private sector, the USA PATRIOT Act also facilitates information sharing between governmental agencies.

## United Nations - UN Security Council Resolutions 1373 and 1390, adopted Sept. 28, 2001 and Jan. 16, 2002, respectively

These resolutions require all UN member states to “Freeze without delay the funds and other financial assets or economic resources” of those individuals and entities designated by the United Nations as belonging to, or associated with, the Taliban or al Qaeda.

Under UNSCR 1390, governments of member states may block those on the UN terrorist list from using their territories as a base of operations or point of transit. The resolution also provides the grounds for making it illegal to deal arms and give training or other assistance to UN-named terrorists.

## International Financial Institutions (IFIs) - The International Monetary Fund (IMF) and the World Bank

Both the International Monetary Fund (IMF) and the World Bank have adopted action plans to work together on anti-money laundering (AML) and the combat against the financing of terrorism (CTF). The plans basically call for both institutions to shape their current anti-money laundering strategies around efforts at stopping terrorism financing. The IMF and World Bank are also studying informal fund transfer systems (*hawalas*) and they are providing technical assistance to weaker states in an effort to bring them up to international AML and CTF standards.

## Treasury Department's "Voluntary Best Practices", issued November 8, 2002

Based on a news release from Treasury, these guidelines were apparently released at the request of Arab American and Muslim charities concerned that their assets might be seized and donations blocked through government efforts to prevent funding of terrorist groups. Some commentators have attacked the guidelines as onerous, unrealistic, and unlikely to have an impact on terrorist financing. The guidelines require additional internal recordkeeping to facilitate responses to possible IRS audits and encourage their public disclosure.

Compliance with the guidelines is meant to reduce the likelihood that charitable funds will be diverted for terrorist purposes, thereby reducing the risk of blocking a charity's assets. Compliance with the guidelines, however, does not ensure a safe harbor to a U.S. charity from a blocking action under any executive order or regulation.

As noted in the NYSSCPA's previous response to IRS (Comments to Announcement 2002-87 dated January 28, 2003), the Treasury deserves commendation for developing anti-terrorist financing guidelines. If Treasury decides to make such guidelines mandatory, the responsibility for implementation and compliance should rest with the charities rather than with their professional advisors.

Nonetheless, since Announcement 2003-29 requested comments regarding public charities' current best practices, committee members inquired of several nonprofits about their best practices in this area. The information they reported is summarized below with commentary:

**Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S. Based Charities**

Summary of responses of 10 public charitable organizations:

- I. Governance
  - A. Governing Instrument - All public charities' governing instruments contained adequate disclosure of the charities basic goals, defined the structure of the charity, and stated that the charity complies with federal and state laws. Only half of the charities questioned had governing instruments that contained requirements for financial reporting, accountability, and solicitation and distribution practices.
  - B. Board of Directors - All public charities questioned had a Board of Directors (Boards) consisting of at least three members. All Boards met at least once annually, one-half met twice annually and one-quarter met at least three times annually. All charities questioned stated they followed conflict of interest policies although only half stated they had formal policies and only a fourth could produce the actual written policy. All charities said minutes were kept of all meetings and all decisions made are documented.
  
- II. Disclosure and Transparency in Governance and Finances
  - A. Board of Directors - All public charities questioned make available a list of its board members and their compensation, including fringe benefits . In addition, all charities maintain identifying records of each board member.
  - B. Key Employees - All public charities questioned make available a list of the five highest paid key employees' salaries and fringe benefits. In addition, the charities all maintain identifying records of the key employees.
  - C. Distribution of Funds - The two charities with subsidiaries or affiliated companies both identify the affiliated entity that receives funds. All charities questioned provide financial statement information or annual reports as requested.

- D. Solicitation for Funds - Generally, the charities' stated goals are understandable to the general public, although they are frequently broadly stated. If a member of the public were to examine a disbursement of funds, however, it is unlikely that they would be able to determine whether the funds were used for exempt purposes. Solicited donations usually only give a general idea of how and where donations will be expended.

III. Financial Practice/Accountability

- A. Budget - The larger public charities adopt a budget on an annual basis while the smaller charities maintain books and records but do not necessarily complete a formal budget.
- B. Financial Officer - Larger public charities appoint a financial officer who either directs the expenditures or is ultimately responsible for the day to day control over the finances.
- C. CPA Firms - All charities polled are New York based charities. Accordingly, if a charity's gross income exceeds \$250,000, New York State law requires an organization to submit audited financial statements with the New York charities bureau filing.
- D. Receipt and Disbursement of Funds - The majority of charities questioned follow generally accepted accounting principles for their financial statement while a small number file tax basis financial statements. All charities questioned make their disbursements by check or wire and all disbursements are recorded including name, address and amount.

IV. Anti-Terrorist Financing Procedures:

- A. A summary of basic information collected by the charities polled before disbursing charitable funds include: name, address and phone number of recipient; business purpose of the organization; names and addresses of affiliates of the foreign organization; names and addresses of officers and key employees; financial statement review; and names of any political affiliations. Charities do not determine normally translate the foreign recipient's organization's name into English.
- B. Basic vetting of potential foreign recipients includes internet searches and research with the Department of Treasury whether the organization is designated as a suspected terrorist organization. While the organizations do obtain names and addresses of key staff and the recipient organization's principal place of business, they do not obtain their full name in English, their language of origin, or place and date of birth of key staff. The charities try to determine that the foreign recipient does not deal with individuals or organizations that support terrorism by requiring the foreign recipient to complete questionnaires and explanations of how the funds will be used.
- C. Financial Operations of Foreign Recipient – The majority of charities attempts to ascertain the existence of a bank account in the country where the organization is located, but usually do not inquire beyond the existence of the account. The charities do not try to determine whether

the bank is a shell bank or operating under an offshore license. Most charities do require the foreign organization to provide statements about grants were used. In addition, although some larger charities visit the foreign recipient, none of the charities polled conduct an audit of the foreign recipient.

### **Government Limitations**

Although the U.S. federal government has stepped in to freeze the assets of numerous charities for which there has been overwhelming evidence of terrorist funding, the government is limited by a lack of information available to support such actions. In addition, there are limits placed on government intervention because of the very freedoms and liberties guaranteed our citizens and because of the lack of government funding.

### **Current Legislative Proposal for Suspension of Exempt Status**

The Senate introduced Care Act of 2003, § 208 (S. 256) which, if passed, would amend Code § 501 to provide for the suspension of an organization's exempt status under Code §501(a) for any period in which it is designated a terrorist organization or a supporter of terrorism. Although the bill was passed by the Senate on April 9, 2003, the bill will be held until the House passes a companion bill, so as not to violate the requirement that revenue bills start in the House.

1. Under the Care Act a terrorist organization is an organization designated or defined as:
  - a) A terrorist organization or a foreign terrorist organization under certain sections of the Immigration and Nationality Act,
  - b) subject to economic sanctions under an Executive Order related to terrorism and issued under the authority of the IEEPA (such as the Bush Executive Order) or section 5 of the United Nations Participation Act, or
  - c) an organization supporting or engaging in terrorist activity designated in any other Executive order in the future or under any federal law that refers back to the Care Act.
2. No deduction for contributions to such terrorist organizations will be allowed during the period of suspension. An organization erroneously designated as a terrorist organization may challenge the designation, but not the suspension itself, and may apply for a refund or credit for any overpayment of taxes resulting from the period of suspension. Notice of any suspension would be published by the IRS.

The Care Act, Sec. 208 provisions for Suspension of Tax-Exempt Status of Terrorist Organizations form an appropriate statutory authority for disciplining such organizations.

### **Case Studies**

Members of the committee conducted inquiries with several nonprofits regarding the practices and safeguards currently in practice to help preclude the diversion of assets for non-charitable purposes. The information they reported is summarized below with commentary:

Public Charity A does not award grants to recipients outside the U.S. In connection with A's exempt purpose, however, it maintains five offices outside the U.S. Each of these offices has received funds ranging from \$20,000 to \$50,000, depending on their cash requirements. On a monthly basis, these impress funds are replenished via wire transfer only after expenditure reports are submitted by the foreign office and approved by A. To maintain financial control, individual expenditures exceeding predetermined amounts must be forwarded to U.S. office for approval and direct payment. A augments its standard banking procedures with an annual budget, a designated financial officer, and an independent audit.

To increase the assurance that donors' contributions are used for their intended charitable purpose, A may require an independent outside evaluation of the foreign project or a financial report with supporting documents from the recipient.

In addition, whenever possible, A attempts to require the grantee to participate in conferences and activities that could provide additional assurance on the proper use of funding. The purpose of this step is to ensure that funds are not diverted because funders have a "know your grantee" system similar to the "know your customer" rules of banking systems. Most of A's conferences take place outside the U.S.

Public Charity B currently has two foreign grants in connection with medical research performed outside the U.S. These grants are typically made over a two-year period in an aggregate amount of \$60,000 each. The grant is only considered by B after receipt of a detailed application by the grantee that includes details of how the funds will be expended. B exercises vetting procedures that include conducting a search of public information via the internet. Most often, B is familiar with the professional credentials of the grantee and all grant applications are subject to a formal review and approval process.

The initial payment of 25% is made in July of year 1 and the second payment is made in January of year 2. All installments after the initial payment occur only after receiving a progress report detailing how the funds were utilized to date and the status of the research project. At the completion of the project, each grantee is required to furnish B with a reconciliation of the entire research project and return any funds that have not been expended.

Public Charity C provides medical research and education here in the U.S. From time-to-time it grants awards (e.g., \$1,500 to \$3,000) for travel reimbursement costs for individuals outside U.S. to attend and participate in medical conferences in the

U.S. C does not make foreign grants or send other money outside the U.S. The reimbursements are made only after full knowledge of the individual's professional credentials and a commitment by the individual to contribute to the medical conference.

Public Charity D is a “*friends of*” organization, soliciting and receiving contributions in the U.S. and expending the funds on behalf of a charitable organization in another country. Its support is primarily provided through program or project grants. In 2002 it began to engage a public accounting firm in the foreign country to conduct on-site agreed-upon procedures that includes a report of funds received from the U.S charity resulting from transfers to D. The U.S. charity then reconciles on a timely basis its disbursements with the report and can identify any discrepancies.

In addition, the report documents the use of the funds in the foreign country with verification. D's operations do not require expenditure responsibility from the foreign country, but rather U.S funds are sent "as required" on the projects as they become available. Three individuals are employed by the foreign charitable organization in the foreign country. These individuals provide D with recommendations of approved projects as well as status reports of projects in progress.

Public Charity E does not award grants to organizations outside the United States. E funds other United States organizations, however, that use them for projects outside the United States. The grants to the United States organizations range from \$50,000 to \$150,000. The U.S. organizations in turn may make foreign grants or use the funds for foreign projects.

Since E does not award foreign grants, it relies on the United States recipient organization to verify the funds are being used for their intended charitable purpose. E requires the United States grantees to provide the following information related to any foreign projects or grants: name and address of the foreign organization; a statement of how the funds will be utilized in the foreign country; names and addresses of the officers, key employees and contractors of the foreign organization; evidence of bank accounts in the foreign country where the funds will be wired or where the project takes place; and a reconciliation of all funds granted to the US organization used for foreign grants or projects. E has not required any additional information since September 11, 2001, although it has increased the enforcement of its existing requirements.

Public Charity F makes grants related to hospitals and clinics in one foreign country. F has been making grants for fourteen years ranging from \$10,000 to \$100,000. F's members continuously visit the foreign country and many of its members are medical specialists. The members visit different hospitals, clinics etc. to determine which organizations are worthy of grants and comply with the charity's mission statement.

Since F's members are medical specialists and visit the hospitals before any grants are made, they are able to verify the need and authenticity of the organization. Before visiting the foreign country, F uses the internet to research possible grantee organizations. It then verifies they are not listed on the US Government Register of Terrorist

Organizations. Under no circumstances does F provide support without first visiting the grantee. F usually delivers checks personally and will not deliver cash nor will it wire funds.

Before delivering the grant, the grantee organization must complete an internal document created by F. The document requests specific information including: names and addresses of officers, key employees etc.; verification of bank account; associations with any political or militant organizations; statement of income and expenses; and statement how the grant will be used. After the grant is received and funds expended, F requires the organization to verify the funds were used for their intended purpose. If they were not, an explanation and reconciliation of the funds must be completed.

F has not made any changes post September 11, 2001 although it performed an extensive review of the grant making process. It determined no changes needed to be made to the process.

Public Charity G makes grants to organizations that provide immigrants with education and assistance in assimilation into the United States culture. Grants are made to both domestic organizations and foreign organizations. Grants usually range from \$1,000 to \$10,000.

Before September 11, 2001, G's grantmaking process was done through word of mouth, research on the internet, and questionnaires to various organizations. Verification was required only after a grant had been consumed or a project was completed.

Post September 11, 2001, G has tightened considerably its grant-making process. Before G considers making a grant, it reviews the US Government Register of Terrorist Organizations to determine whether an organization is on the list. Currently, G requires organizations to supply the following before a grant is made: names and addresses of the organization, officers, key employees, contractors and subcontractors. In addition, G requires the grantee to have a current bank account in their country of origin. G will only send checks where as in the past it has wired funds. G's grant agreement now requires review of financial statements, third party verifications and a complete reconciliation of how the grant was used.

## **Recommendations**

### **Expand Required Information on Schedules**

The current Form 990 requires an attached schedule for grants made by exempt organizations requiring (a) each class of activity; (b) donee's name, address, and the amount given; and (c) (in the case of individuals) relationship of donee if related by blood, marriage, adoption, or employment to any person or corporation with an interest in the organization, such as a creator, donor, director, trustee, officer, etc.

Form 990 should be modified to include a Schedule of Foreign Operations, which would include the following:

- Name and address of recipient organization
- Class of activity furthered by the grant
- Geographic area(s) involved
- Has the organization collected basic information about foreign recipient organization(s)? (Yes/No) **Note** - The instructions to the Schedule should include what basic information is required about the foreign recipient.
- Has the organization conducted basic vetting of potential foreign recipient organization(s)? (Yes/No) **Note** - The instructions to the Schedule should include an explanation of the phrase basic vetting of potential foreign organization(s).

### **Education**

IRS should embark on an education campaign to raise awareness of charities in an effort to stop unintended funding of terrorists. This would include information included with IRS publications and on its website, TE/GE Education and Outreach conferences, workshops and seminars to help the public identify potential red flags that would include:

- Corporate layering - e.g., transfers between bank accounts of related entities or charities for no apparent reason
- Wire transfers by charitable organizations to companies located in countries known to be bank or tax heavens
- Lack of apparent fund-raising activity (i.e., lack of small checks or typical donations) associated with charitable bank deposits

In addition, IRS should make anti-terrorist financing procedures available to charities. These would set out the steps to be taken before expending charitable funds to or for foreign recipient organizations.

IRS should target mailings of both notifications of Outreach conferences, workshops and seminars and these educational materials to all charitable organizations.