

PUBLIC COMMENT ON
“INTERNATIONAL GRANTMAKING AND INTERNATIONAL ACTIVITIES BY
DOMESTIC 501(C) (3) ORGANIZATIONS”
SUBMITTED JOINTLY BY INTERACTION AND INDEPENDENT SECTOR
JULY 18, 2003

BACKGROUND

InterAction is the largest alliance of U.S.-based international development and humanitarian nongovernmental organizations. With more than 160 Members operating in every developing country, InterAction and its membership work to overcome poverty, exclusion and suffering by advancing social justice and basic dignity for all.

INDEPENDENT SECTOR is a national coalition of over 700 nonprofit organizations, including many of the nation's leading foundations, prominent and far-reaching nonprofits of all sizes, and Fortune 500 corporations with strong commitments to community involvement, which represent millions of volunteers, donors, and people served. Its mission is to promote, strengthen, and advance the nonprofit and philanthropic community to foster private initiative for the public good.

Together, InterAction and INDEPENDENT SECTOR represent some of the largest international humanitarian relief and development agencies in the world, as well as numerous smaller groups working at a grass roots level overseas. Our Members come from both the faith-based and secular communities. Collectively, they provide assistance to hundreds of millions of people in every developing country throughout the world. Many of these organizations manage sizable USAID and other U.S. Government grants, in addition to funding from diverse sources: individuals, foundations, corporations, international organizations and foreign governments. Their work is implemented through networks of overseas offices of various sizes and levels of sophistication, through direct employment of local and expatriate staff as well as through strategic partnerships with local organizations to develop local capacity. Partnership with local organizations is frequently required or encouraged by donors, including the U.S. Government, and is consistent with sound development policy. Such partnerships require subgranting or subcontracting to local organizations.

Both InterAction and INDEPENDENT SECTOR have played a key role in the dialogue with the U.S. Government concerning efforts to ensure that not-for-profit organizations take appropriate steps to prevent charitable funds from being diverted to impermissible uses, including terrorism. InterAction provided feedback to an interagency task force on terrorism and NGOs in 2000. Additionally, attorneys from some of the Members of InterAction have previously engaged both USAID and the IRS in response to those agencies' respective efforts to ensure the proper use of charitable funds. INDEPENDENT SECTOR has provided comments on numerous occasions to the IRS, most recently in response to Announcement 2002-87 in January 2003.

We welcome the opportunity to present our views here. We also note the efforts of our colleagues at the Council on Foundations and the ABA Task Force on Exempt Organizations, each of which has submitted comments to the IRS separately. While our three sets of comments do not agree in all respects, taken together they provide the IRS with a comprehensive view of the charitable community's response to the counter-terrorism developments.

The views expressed in this memorandum of InterAction and INDEPENDENT SECTOR are distinctive because they represent the concerns and operational realities of public charities (all Members of InterAction and 453 Members of INDEPENDENT SECTOR are public charities). Many of these organizations (including almost all Members of InterAction) work very closely with foreign counterparts on the ground, and thus would be seriously affected by any proposed regulatory changes. Because of their proximity to their foreign partners and operations, our Members have particular operational, administrative and security concerns with regard to counter-terrorism measures. In addition, the views of our Members offer unique insights into what practical difficulties are likely to result from implementation of new regulations, how they would be viewed by our overseas counterparts and the impact on achieving the humanitarian, economic and social development objectives of both our Members and, when it involves their funding, the U.S. Government.

In order to establish the context for our comments, we thought it useful to provide the following information about our Members and their activities:

Some of our Members maintain substantial field operations overseas. In addition to hiring their own staff and running their own programs, they also sub-grant funds to other organizations, including increasingly to non-U.S., local organizations, to implement programs. This grantmaking activity is an integral means of building partners overseas and contributing to sustainable development, and is often essential in order to ensure effective relief and development programming. One aspect of building sustainable local partners is to educate them in appropriate reporting, accounting and other internal controls to ensure transparency. For some of our larger Members, this kind of capacity-building, grantmaking activity can be as much as 12% of program expenses, amounting to tens of millions of dollars annually for each of these Members.

In contrast, some of our Members perform only limited international grantmaking and may not have a presence overseas at all. Nonetheless, their international work is an integral part of their mission.

Not all assistance provided by our Members overseas is in the form of grants. Many of our Members engage in microfinance activity, providing small loans in order to stimulate entrepreneurship and community development. For some of our larger Members, these programs expend tens of millions of dollars annually, to hundreds of thousands of beneficiaries, with average loan sizes on the order of \$250. Many Members also provide direct support (food, water, medicine, shelter and supplies) to refugees and others. Such emergency assistance serves millions of beneficiaries each year.

Some of our Members are affiliated with large multinational, not-for profit organizations, and they regrant funds to their overseas affiliates that in turn operate programs overseas. The relationship between the domestic affiliate and the multinational is close; there is complete transparency between the domestic and overseas affiliates, and the domestic affiliate maintains full discretion and control over the use of its funds.

Some of our Members are religiously affiliated charities representing a variety of faiths, including Catholic, Protestant, Jewish and Muslim, that have close ties to their faith communities overseas. They often work through these overseas faith communities, making grants to them and to other organizations to carry out humanitarian and development work. For the most part, these overseas faith communities are not subordinate to their American counterparts as a matter of law or of religious doctrine. Some of the local faith communities are constituted informally; in some countries, they may be unable to operate or organize formally because of official persecution. The links between the American faith-based organization and its foreign counterparts are frequently close and longstanding. Some Members report cooperation in development programs spanning decades.

Many of our Members receive significant levels of funding from the U. S. Government to undertake large-scale programs, including disaster assistance, assistance to refugees and displaced persons, and reconstruction and development. These programs further the humanitarian and development goals of our Members, and are consistent with American interests around the world, as evidenced by the U.S. Government support. For example, according to USAID, in FY 2001, 77% of the \$158 million in funding from its Office of U.S. Foreign Disaster Assistance was distributed through not-for-profit organizations, mostly public charities. According to USAID, almost 60% of its overall procurement activities in FY2002, representing a sum of almost \$3 billion, was made to the nonprofit sector. (In contrast, the total level of international grantmaking by public charities in 2001 was approximately \$1.6 billion. International grantmaking by private foundations and corporate donors stood at \$2.46 billion.)

Our Members are actively involved in designing and implementing programs funded by the U.S. Government around the world, including in Iraq, Afghanistan, Pakistan and the Israeli-occupied territories. Our efforts to bring health care, education, humanitarian assistance, human rights and other public goods to underserved populations around the world are supported by the contributions of millions of Americans and by funding from our government. We are an integral part of what defines the United States as a uniquely philanthropic country.

Most of our Members are organized as public charities under U.S. tax law. Because they receive significant levels of financial support from the general public, public charities pay particular attention to public accountability. This public support provides a built-in mechanism for protecting against abuse, as revelations of abuse lead quickly to a decrease in public support. The drop off in support for the United Way after a scandal in the early 1990's is but one demonstration of this phenomenon.

IRS REQUEST FOR COMMENTS

Below we paraphrase each component of the IRS request for comments, followed by our response.

1. *What specific practices and safeguards are currently used by public charities and private foundations to ensure that grants to foreign recipients are not diverted to nonexempt purposes and overseas activities are in furtherance of exempt purposes? ...*

a. *What kind of due diligence investigation is done in advance of grantmaking?*

Our Members' grantmaking generally already incorporates due diligence designed to establish the bona fides of a grant recipient to carry out the stated purpose of the grant and to ensure against diversion for other purposes. Such due diligence will vary by size of grant; by capacity of grantmaker; and by country, depending on local infrastructure and the presence or absence of the information sought. (In some regions where our Members work, for example, there are no copy machines, no reliable electricity and intermittent satellite access for phones and Internet).

Typically, this due diligence includes review of: public information about the organization, its past and present activities, the qualifications of its principal personnel, and the organization's stated purpose and charter. Much of this due diligence involves learning about the reputation of the organization from other international and established local NGOs working in the same field. Local legal requirements may also impose certain due diligence steps, such as a requirement of a police check of a local organization before funds can be distributed. Moreover, the primary grantmaker (e.g., the U.S. Government) frequently establishes its own specific criteria for regranting its funds to a local organization that require other forms of due diligence, such as obtaining certifications from subgrantees with regard to terrorism, narcotics trafficking, etc.

Much of our Members' overseas grantmaking is to organizations with which our Members have longstanding relationships and a long track record of good accountability. Many of our Members employ local staff to manage and implement their programs and operations. These staff members grow up and live in the community, and know the local context. These are often the first people, and the best equipped, to evaluate the bona fides of a local organization.

b. *What provisions are used by grant agreements to ensure grants are used for their intended purpose?*

Grant agreements typically define the responsibilities of donor and recipient, with the recipient required to expend the funds on a defined purpose and set of activities.

Agreements typically include a timeline and budget for the activities, and require various kinds of reporting and audits, depending on the size of the grant and the requirements of the primary donor. Agreements typically provide that grant funds must be used only for the stated purpose and activities, and that funds not used or not used for that purpose or activities must be returned to the donor. A record of misusing grant funds will preclude an organization from receiving funding in the future.

c. What reports or other mechanisms are used to track the use of grant funds?

Reporting requirements are common, and include narrative and financial reports, photographic and other visual documentation, and, for substantial grants or where otherwise required by donors like USAID, independent auditing of financial information according to generally accepted accounting principles. Moreover, in the case of our many Members that are operating programs in the field, they will have first-hand, day-to-day confirmation that grant funds are being used for intended charitable activities. This kind of direct connection to the grantee provides strong assurance that charitable funds are well and properly spent. Many of our Members also subject grantees to random audits, target larger grantees for selected audits, and make grantees the subject of external audits.

d. If a public charity or a private foundation makes repeated grants to the same foreign grantee, how often does it perform renewed due diligence on the grantee?

Repeated grants to the same grantee means that the relationship between the donor and the grantee is strengthening and the results productive, and hence more information is passing from the grantee to the donor on a regular basis. For those of our Members that maintain operations in the field, repeated grants to the same foreign grantee are a demonstration of a continuing working relationship on the ground. This working relationship typically includes close communication with program and administrative staff, regular site visits to the grantee, review of all relevant public information about the grantee, as well as the reporting that is mandated by the grant agreement. For grantmakers that do not have a presence in country, or who give small or infrequent grants, such steps may not all be feasible.

e. Are the grant agreements, reports, and other significant correspondence written or accurately translated into English? Are grant funds disbursed by check? By electronic funds transfer? By cash?

Grant agreements, reports and other significant correspondence typically are generated in English, with translation into local languages as needed. In countries with functioning banking systems, and where the recipient organization is formally constituted and maintains a bank account, electronic funds transfer and the use of checks are the most common practices. However, in some countries, the banking system does not function; governments may impose confiscatory bank fees, taxes, exchange rates and other levies on grants; or the banking system may offer insufficient protection against theft. In these

cases, cash transfers may be necessary. For example, in Somalia, banking systems are weak, necessitating the use of cash. In Afghanistan, the only functioning system remains the “hawala” system, an informal system of money transfer, without which all assistance programs in Afghanistan, including U.S. Government-funded programs, would stop functioning.

2. *In the aftermath of September 11, 2001, what review or changes in practice have organizations made to ensure that grants are not diverted to support terrorism or other non-charitable activities?*

The following practices have been reported by some of our Members: first, they have established enhanced procedures for checking the lists of blocked organizations and individuals maintained by various departments of the U.S. Government, the European Union and the United Nations; second, they have trained staff in the requirements of Executive Order 13224, the Patriot Act and other relevant U.S. law; third, they have established working groups to ensure compliance with U.S. law; and fourth, they have promulgated internal policies to address relevant issues. For those Members who receive USAID or other U.S. Government funding, they comply with all legal requirements attached to government grants (including certifications regarding terrorism).

While our Members are striving to comply with all the new requirements of U.S. law, the existence of so many different U.S. Government lists of “prohibited” organizations and individuals (not to mention lists maintained by the United Nations, the European Union and other countries) makes review of them much more difficult. The need for a unified U.S. Government list that takes into account those of objective international organizations and other governments is acute. Moreover, some names on the lists are the equivalent of “John Doe” in certain foreign countries and therefore do not help in identifying particular bad actors. Because many overseas offices suffer from interruptions in electricity and satellite connections, continuous monitoring of the lists may be difficult locally. Regular and periodic updates (e.g., quarterly) of a consolidated list would allow headquarters offices to download it and distribute it to overseas offices more efficiently.

3. *What difficulties have public charities and private foundations encountered in monitoring how international grants are actually used, or how international activities are conducted? Are there particular types of grants, recipients or activities that are easier to monitor than others?*

Our Members report that they do a good job in monitoring the use of their international grants and in ensuring that they are used for charitable purposes. There are, however, certain logistical and infrastructure difficulties in some countries that limit the ability to gather information. Access may be limited to program sites that are often remote or rapidly changing in emergency situations. Communications systems may be far below American standards, with sporadic or no access to telephones, electricity, Internet

connectivity or mail. Clearly, the monitoring of the expenditure of funds must be tailored to the circumstances and capacities of local partners and the context of the program. Not all steps are feasible with all grantees or with all donors.

However, in spite of these challenges, our Members have demonstrated their ability to maintain the necessary and appropriate levels of control in order to monitor the use of charitable funds, using the tools of pre-grant vetting of local partners, written agreements requiring periodic and final reporting, ongoing support and training of partner staff during the term of a grant and site visits. Given the many factors that influence the monitoring process, our Members are not prepared to say that any particular types of grants, recipients or activities are more or less easily monitored. With the best local knowledge, our Members are in the best position to evaluate such factors and tailor their monitoring accordingly.

While the IRS request for comments is largely concerned with grantmaking, on several occasions the request for comments refers more generally to “overseas activities,” or “international activities,” very general terms that could be interpreted to cover much more than grantmaking. The concerns we express herein about existing IRS regulations and the Treasury Department Anti-Terrorist Financing Guidelines (hereinafter the “Treasury Guidelines”) with regard to grants would apply with greater force if one contemplated extending such regulation to activities such as vendor transactions, microfinance, matching gifts, or provision of humanitarian assistance directly to individual beneficiaries. The practical burden of applying additional requirements to these activities (for example, a requirement to gather information on every customer which a vendor serves, every loan recipient in a microcredit program, every small matching gift in conjunction with employee charitable contributions, or every refugee in a camp that may hold one hundred thousand people) would cripple our Members’ work and could very well lead to the loss of innocent life.

4 a. Are there additional requirements that should be added beyond those already specified in Rev. Rul. 56-304, Rev. Rul. 63-252, Rev. Rul. 66-79, and Rev. Rul. 68-489 to reduce the risk that charitable assets may be diverted to non-charitable purposes? Please also comment on how any burden associated with any new requirements might be mitigated.

InterAction and INDEPENDENT SECTOR do not believe that changes to these Revenue Rulings or additional requirements are needed to reduce the risk that charitable assets are diverted to non-charitable purposes.

Two of the rulings (63-252 and 66-79) concern the deductibility to individuals of contributions to domestic charities that use those contributions for foreign projects. In order to qualify their donors’ contribution for federal income tax deductions, the charity must review and approve any use of funds internationally and must maintain control over the use of such funds to ensure that use furthers the charity’s exempt purposes. Each Ruling provides further guidance as to what does and what does not constitute sufficient

review and control. Maintaining deductibility of contributions is a critical matter to public charities and these rulings offer a clear and significant incentive for charities to monitor closely their international activities. Our Members do not believe that the absence of specific requirements as to what kinds of information the domestic organization need gather from or on potential recipients of funding diminishes the authority or weight of these Rulings.

In the context of preserving its tax-exempt status when distributing funds to non-exempt organizations, Ruling 68-489 requires charitable organizations to limit distributions to specific projects in furtherance of their own exempt purposes, retain control and discretion over the use of distributed funds and maintain records to establish that funds were so used. Preservation of tax-exempt status is crucial to our Members and this Revenue Ruling clearly states the mechanism charitable organizations must use to do so. The diversion of funds to non-exempt purposes puts at risk one of the most valuable assets a charitable organization has. The absence of specific requirements as to what kinds of information domestic tax-exempt organizations need gather does not diminish the authority or weight of this Ruling. It appropriately leaves discretion and judgment with the charity as to what kind of record keeping is adequate to establish that funds transferred to a non-exempt organization are being used for charitable purposes, thereby protecting its tax-exempt status.

The final Revenue Ruling (56-304) addresses the requirements for making monetary distributions to individuals. It requires the distributions to be made on a charitable basis; the maintenance of adequate records as to the recipient, the amount and the purpose; the manner of selection and the relationship, if any, of the recipient to the organization's trustees, officers, substantial contributors, or other related entities. Like the other Rulings, this one adequately serves the purpose of ensuring the organization is sufficiently familiar with the recipient of monetary assistance to be able to demonstrate that the assistance is for charitable purposes.

The IRS has recognized the impracticality of detailed record keeping as to individuals in certain situations, see for example "Disaster Relief: Providing Assistance Through Charitable Organizations" (Pub. 3833, p. 10). If any revision to the Ruling is undertaken, our Members believe it would be appropriate to incorporate the delivery of aid in certain situations (like disasters, emergency situations and microfinance) into a new, more comprehensive ruling. In these cases, it should be possible to demonstrate that funds are being used for charitable purposes through customary record keeping of program activities and expenditures, without record keeping as to individual beneficiaries, which would be impossible in many settings.

While the Revenue Rulings are sufficient, there is an ongoing need to educate public charities about their requirements, particularly in light of the prohibition on providing assistance to terrorists and terrorist organizations. Both InterAction and INDEPENDENT SECTOR are engaged in this ongoing educational effort.

4 b. What specific changes to Forms 990, 990-PF, and 1023 would you recommend to allow for better monitoring of international grantmaking and international activities by the IRS, and by other government agencies and members of the public who can review these forms as public documents?

On January 28, 2003, four Members of InterAction submitted comments to the IRS in response to Announcement 2002-87 – “Form 990 Series Developments and Request for Comments Regarding Possible Changes.” In these comments, the four organizations stated their view that no additional reporting and informational requirements in Form 990 are required, and proposed instead adding a certification referring to the prohibition against support to individuals and organizations designated under Executive Order 13224. INDEPENDENT SECTOR submitted comments to the IRS on the same issue and came to the same conclusion with regard to Form 990 requirements. On behalf of all the Members of InterAction and INDEPENDENT SECTOR, we reaffirm those comments and our belief that changes to Form 990, 990-PF and 1023 would be an unnecessary burden. We are attaching a copy of the January 28, 2003 letter and the INDEPENDENT SECTOR comments for your review.

5. ...[T]he IRS is... interested in learning which of the best practices specified in the [Treasury Department Anti-Terrorist Financing Guidelines] organizations currently use. The IRS is also interested in learning whether these currently used best practices are useful in achieving compliance with federal income tax requirements and appropriate for other public charities and private foundations to follow.

We will address each section of the Treasury Guidelines briefly. The first three sections of the Guidelines (Governance; Disclosure/Transparency in Governance and Finances; Financial Practice/Accountability) contain provisions to which our Members commonly adhere, although we share the concerns expressed by the Council of Foundations in its letter of June 20, 2003 to the General Counsel of the Department of the Treasury that some provisions are contradictory and that they should not be considered as “best practices.” Many are basic provisions of good governance, similar to guidance promulgated by the Better Business Bureau (see BBB Wise Giving Alliance Standards For Charitable Accountability), InterAction (see our PVO Standards) and others, and some mirror existing requirements in federal and state law. Thus, we see no need for the IRS or the Treasury Department to promulgate them on either a voluntary or mandatory basis, precisely because those that are considered good practice already exist as either voluntary guidelines or mandatory provisions of federal and state law.

The most salient provisions in the Treasury Guidelines are those in Section IV, entitled Anti-Terrorist Financing Procedures. These Guidelines require that a charity collect “basic” information about a foreign recipient organization. While some of these Guidelines are consistent with the current practice of our Members, many of them go way beyond what is practiced and practicable, requesting an overly broad sweep for information, much of it of no relevance to the charitable endeavor. These Guidelines,

were they to become mandatory, would require a substantial increase in the administrative costs associated with international activities, would severely impair and in many cases preclude American NGOs from operating effectively overseas and could shut down many vital humanitarian and development programs.

As noted above, some of the information sought by the Section IV Guidelines is similar to that which is commonly collected by many of our Members as part of their due diligence. Ordinarily, it is not burdensome to collect the following information about local grantees: name, physical presence, jurisdiction of incorporation, contact information for principal places of business, the principal purpose of the organization, public filings and annual reports. However, such information may not be available in every case (for example, public filings may not exist or may not provide useful information; informal organizations are not incorporated; some groups may work in places with no functional office and that have no phones, electricity or mail delivery, making it impossible to identify contact information for all places where an organization does business).

Certain information may be feasibly obtained by some types of American NGOs, but not others. For example, many of our Members, particularly those that maintain operations in the field, may conduct on-site audits of grantees (and particularly of large or repeat recipients). However, such auditing is not feasible for many Members that do not maintain overseas operations. It is also not feasible for those that give numerous small grants to many different organizations in different countries.

Members are already checking would-be partners against the various “terrorism lists” and some are creating systems to automate this process. InterAction and INDEPENDENT SECTOR recognize the need to educate our members continuously on this requirement and to share experiences in this regard. At the same time, we reiterate the need for a consolidated list, with more detailed identifying information, updated on a regular basis, in order for public charities to carry out this task effectively.

The remaining information described in Section IV of the Treasury Guidelines cannot be feasibly obtained on a regular basis, for reasons of security, privacy, maintaining independence and impartiality, and cost. This includes the broad requests for information about all funding and material support provided by the recipient (item A6); names and addresses of all subcontractors (item A7); existing sources of income (item A9); information about financial institutions (item C1); and information from on-site audits (item C4).

As some of our Members have noted in prior communications with the IRS, USAID and other U.S. Government agencies, proposals to require charities to gather more information about local partners or grantees raise serious threats to our Members’ missions and personnel. Our Members are engaged in every developing country in the world and are present at every significant disaster and armed conflict requiring international assistance. NGOs are able to function in such difficult milieus because of their reputation for impartiality and operational independence from governments. The necessity for such impartiality is affirmed in such self-regulating guidance as the “Code

of Conduct for the International Red Cross and Red Crescent Movement and NGOs in Disaster Relief.” The more that our Members are required to gather information that is extraneous to their charitable mission, and the more that our Members are perceived as agents of a government in carrying out that information gathering, the more their impartiality is compromised and the more difficult their missions become.

Some prospective partners will simply not cooperate with American NGOs if they are perceived to be agents of the U.S. Government with whom cooperation could compromise their own impartiality, independence and security. In December 2001, the USAID mission for West Bank/Gaza requested detailed information from American NGOs about their local partners, including names and identification numbers of partner staff and Board members, dates and places of birth, and home addresses. Merely making this request had a strong and immediate chilling effect on cooperation with the local partners, who reacted with alarm and skepticism. Many of our Members’ partners began to view the American NGOs as arms of the U.S. Government, and there was a public campaign to boycott USAID funding and American NGOs. A resolution to this crisis was eventually reached with the assistance of InterAction and with the acquiescence of USAID to a much more limited information request.

Moreover, this is not a mere philosophical concern but has real implications for staff security. Several NGO personnel were detained for months in 2002 in the former Yugoslavia on the misperception that they were providing information to NATO personnel. Increasingly, humanitarian workers have become the targets of politically motivated violence and intimidation, with several murdered this year in places like Afghanistan, Liberia and Chechnya. American NGOs operating in predominantly Muslim countries face particular suspicion and risks to the security of their personnel, in part because of the perceived hostility of the U.S. Government.

The threat is arguably even greater for local staff (of both American NGOs and local partner organizations) than for expatriates. Local staff lack the protection afforded by foreign citizenship: they cannot leave the country if conditions deteriorate, and they cannot call on the intervention of a foreign protecting power. In many areas of armed conflict, any association with an American or other foreign NGO carries with it heightened risk for a local national. We are very concerned lest this risk increase by requiring local staff to be involved in the collection of information that is of questionable relevance to the charitable purpose of our work.

In some cases, certain kinds of due diligence may simply be impossible. In many developing countries where our Members operate, certain information requested in the Treasury Guidelines is unavailable. Official records of incorporation and other supposedly public data maintained by the government are frequently not maintained in reality. Moreover, some grantees may not be formally constituted at all, because there is no legal infrastructure in place for NGOs or because, for example, a human rights NGO would never be permitted by the government to register as a legal entity for political reasons. As was the case in the Communist bloc throughout the Cold War, in many countries today groups promoting systemic change simply cannot function in a manner

recognized or approved by host governments. For example, in Sudan, many NGOs, international organizations and governments (including the U.S. Government) have provided assistance in cooperation with the Sudan Relief and Rehabilitation Administration, which has no legal status with the Government of Sudan.

The intensive information gathering effort suggested by the Treasury Guidelines is unrealistic when measured against the reality of much development activity. For example, one Member described its program of food assistance in India, which works through a network of over 2500 local organizations throughout the country. Were the Member to undertake the kind of information gathering suggested by the Guidelines for each of its 2500 local partners, the information-gathering component could dwarf the actual provision of food and services in terms of cost and complexity. As another example, in post-war Iraq, the U.S. Government has urged American NGOs to deploy quickly to deliver humanitarian and development assistance. One program that the U.S. government has recently funded through NGOs is the “Iraq Community Action Program,” which, in the words of USAID, is “designed to promote citizen involvement in community development efforts at the grass-roots level.” The program is designed to serve 250 communities and 5 million people. In a country with no functioning legal system, no functioning banking system, and with countless people complicit in the crimes of the Hussein regime, the challenges to performing appropriate due diligence are obvious. While our Members are determined to use best efforts to ensure that charitable funds are not diverted in Iraq, extensive information gathering in this environment will simply not be feasible.

As noted in the example above from the West Bank, grantees would regard requests for detailed staff identification information to be unduly intrusive and unrelated to any kind of reasonable due diligence. We have no doubt that grantees would have the same reservations about broad requests for information concerning subcontractors or financial institutions that are unrelated to a particular partnership program. Requiring our Members to gather such information at the request or for the benefit of the U.S. Government would compromise the independence and integrity of our Members, expose their staff to great personal risk, alienate local partners, and chill charitable activity.

Some of our faith-based Members note that such information requests to a foreign counterpart would be inconsistent with institutional relationships as defined within the framework of their faiths, and would undermine principles of fraternal trust and solidarity. Moreover, they state that detailed requests for information from American organizations, particularly if perceived as at the behest of the U.S. Government, could complicate the relationship between faith-based partner organizations overseas and their host governments.

Requiring the collection of such information would also make the cost of charitable activity overseas prohibitive for many NGOs. Most NGOs are simply not equipped to gather the large volume of information that the present Guidelines identify as desirable. Most NGOs lack the expertise to vet financial institutions along the lines suggested by the Guidelines and would have to outsource such vetting to experienced organizations or

else hire additional personnel. NGOs that engage in small levels of grantmaking overseas without maintaining a presence in the countries in question would find it impossible to comply with mandatory due diligence requirements along the lines of those in the Guidelines; for many grantmakers, the cost of such due diligence would exceed the value of the grants themselves. The effect might be a bias in favor of large grants to large organizations, thus precluding the work of smaller organizations, and threatening the ultimate reach of charitable activities. In many countries, informal organizations working at the grass-roots level are at the forefront of positive social, economic and systemic change. It is important that regulations not create insurmountable hurdles to funding groups that may be our Members' most important partners.

A FEASIBLE COMPLIANCE FRAMEWORK

Public charities overall have a very strong track record in ensuring that their funds are not used to support noncharitable purposes, including terrorism. We believe that existing law (including IRS regulations and Revenue Rulings), in combination with a more informative, user-friendly list from the U.S. Government of prohibited organizations and individuals, offers the best set of tools for compliance.

We note that our colleagues from other parts of the nonprofit community have suggested the value in applying heightened scrutiny and reporting requirements to grants deemed to be of particularly high "risk" of diversion. Our colleagues have suggested differentiating grants according to a number of criteria, including location of the grantee, presence or absence of social unrest, civic turmoil or violence in the country where funds are to be expended, familiarity of the grantee to the donor community or to the U.S. Government, etc.

We agree that all of our Members have a responsibility to assess the risk of diversion of funds associated with their grantmaking and other activities. This responsibility is contained in existing law and regulations, and our Members are committed to continuously improving their means of compliance. We also agree that such risk assessment will be different in different circumstances. However, these circumstances resist easy categorization, and it is vital, therefore, that our Members retain the discretion to conduct such a risk assessment in the manner that they see fit.

The application of fixed categories of risk raises the following concerns:

First is the problem inherent in defining the categories of risk themselves, which, though intuitively appealing, lack empirical support. Thus, there is no evidence to support any correlation between the size of the grantee and the risk of diversion, or that new grantees with less of a programmatic track record are riskier than long-established grantees. For every anecdote in favor of one view as to risk, there is one on the other side of the argument. For example, many well-known organizations have an established track record of legitimate charitable activities in addition to a track record of terrorism. With terrorist front organizations operating throughout Western Europe and the United States,

as well as in countries like Saudi Arabia or Pakistan, even differentiating by country or region is of questionable value.

Second, those qualities identified by some as indicative of higher risk go hand in hand with those that make heightened due diligence more difficult to carry out. Thus, countries where there is active armed conflict, where significant territory is not effectively controlled by the government, or where there is a history of terrorist activity are likely those countries where banking systems function poorly or not at all (necessitating cash transfers), where the legal infrastructure for NGOs is lacking or non-existent, and where political polarization creates a major security risk for staff of NGOs that are perceived to be partisan. Thus, heightened due diligence of the kind described in the Treasury Guidelines may be impossible in those places where it is supposedly most needed.

Finally, those countries where the risk is posited to be the highest are also some of those countries where humanitarian crises are most acute and where the intervention of American NGOs is most critically needed. They are also frequently countries where the U.S. Government interest in providing assistance through NGOs is very high (both for humanitarian reasons and for political reasons of encouraging stability and development as a bulwark against political extremism and terrorism).

In order not to stifle critical charitable activity, therefore, it is important that our Members retain the discretion to determine where and when heightened scrutiny is warranted, and what kind of scrutiny will suffice to ensure that funds are not used for improper purposes. We believe that current law and regulations, with one important area of clarification, provide a feasible compliance framework as follows:

First, it should be the responsibility of the U.S. Government, and not that of public charities, to identify which organizations and individuals should be blocked. The U.S. Government should compile and publish this information in a usable format (one list that incorporates those of other objective countries and international organizations, updated on a regular basis). The list should contain sufficient information to make identification feasible (enabling readers to distinguish among various “John Doe” names, for example). This is the one area where we believe clarification and improvement is needed.

Second, it is the responsibility of public charities to check these lists and ensure that their grants are not being provided to blocked entities, and to document that this is being done.

Third, public charities should perform due diligence to ensure that their grants are not diverted by the immediate grant recipient to blocked entities. The framework for such due diligence is already contained in the requirements of Revenue Ruling 68-489:

- a) to limit distributions to specific projects in furtherance of the organization’s own exempt purposes;
- b) to retain control and discretion over the use of distributed funds; and
- c) to maintain records to establish that funds were so used.

The exact content of this due diligence will vary according to the particular circumstances of each grant relationship and will take into account many factors (including program content and means of delivery) in addition to those suggested by the commentators advocating a differentiated risk approach.

The existing Revenue Rulings, while providing general guidance, also provide sufficient flexibility to allow public charities to comply and not compromise their programs. The Rulings have functioned well up until now by vesting discretion in the public charities to determine how best to ensure that funds are used only for charitable purposes. The Treasury Guidelines appear intended to address inadvertent diversion of funds to blocked individuals or organizations, but there is no evidence that the present Rulings are not sufficient to prevent such inadvertent diversion. What is needed is not new regulations, but education and publicity to make sure that the charitable community is aware of existing requirements. To this end, InterAction and INDEPENDENT SECTOR have been educating our Members about these requirements and will continue to do so in the future.

RECOMMENDATIONS

In summary, InterAction and INDEPENDENT SECTOR recommend:

1. Continued reliance on existing laws and regulations to ensure no diversion of funds to terrorism, including Rev. Rul. 56-304, Rev. Rul. 63-252, Rev. Rul. 66-79, and Rev. Rul. 68-489, without changes.
2. No changes to Forms 990, 990 PF or 1023.
3. Withdrawal of Treasury Department Guidelines in their entirety.
4. Action by the U.S. Government to produce a consolidated list of blocked organizations and individuals, with sufficient identifying information, and with regular updates.

We thank the IRS for its consideration of these comments.