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Charity Considered as a Terrorist Tool

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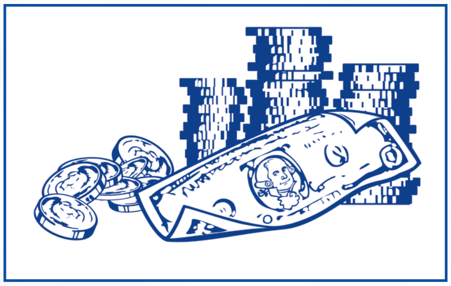

Among the more surprising developments reported in the months since the attacks on the World Trade Center is the revelation that terrorists and their sympathizers may have been using one of America's greatest strengths — its tradition of philanthropy — to undermine national peace and security. The weapons have not been airplanes or shoe bombs, but charitable dollars.

The methods of terrorist groups apparently involve exploitation of nonprofit laws and abuse of the permissive rules that govern commercially related donor-advised funds – the charities associated with brokerage houses that allow people to make deposits into special charitable accounts, receive an immediate tax deduction on their gifts, and then recommend which nonprofit groups should receive grants from the accounts.

The problem of charitable front groups is not entirely new. There have been occasions in past decades when nonprofit organizations were exposed after trying to conceal the true nature of their financial support or the true nature of their objectives. In 1939, for example, the German and Hungarian War Veterans Post applied for a nonprofit charter in the state of New York, but was denied the charter based on the strong suspicion that it was a Nazi Bund dedicated to undermining the government. There also have been allegations that American intelligence agencies in past years used nonprofit organizations in other countries as front organizations to support covert operations.

And then there is a less subversive but no less deceptive type of front. *The New York Times* reported a few years ago that a nonprofit organization supposedly consisting of "concerned restaurant owners" who were opposed to an anti-smoking ordinance, was in fact created and funded by an arm of the tobacco industry.

In the wake of the September 11 attacks, the problem of charitable front groups has reemerged in a particularly dangerous manner. The Bush administration has declared that it suspects several Muslim nonprofit groups operating in the United States, including the Benevolence International Foundation, Global Relief Foundation, and Holy Land Foundation for Relief and Development, of being fronts for terrorists committed to violent activities here or abroad.

These allegations, if proved true, raise serious questions about the way the government oversees charitable organizations. If the groups in question are indeed terrorist organizations masquerading as charities, how did they manage to get charters, tax exemptions and, in at least one case, a church designation from the Internal Revenue Service? Did the IRS simply take at face value the groups' descriptions of themselves as legitimate charities? If so, post-September 11 realities may require that we think differently about the way we charter nonprofit groups and exempt them from taxation.

A related issue is whether the donor-advised funds run by investment houses have thoroughly investigated those nonprofit organizations that receive grants from their contributors. As charities, donor-advised funds are not subject to the stricter reporting requirements and other regulatory controls that apply to private foundations, and therein lies the funds' special vulnerability.

One reason the issue is so important is that donors use these funds to funnel billions of dollars to charities each year, often anonymously. Fidelity's Charitable Gift Fund, with $2.6 billion in assets in 2001, now raises more in private funds than any group except the Salvation Army. It distributed $574 million in grants to charities in 2000. The size and clout of the commercially associated donor-advised funds have put them under the national media spotlight in the wake of the September attacks and the administration's subsequent scrutiny of Islamic charities.

Fidelity announced that it would not distribute grants to organizations that the government identifies as suspect. Fidelity's move was no surprise, considering that the brokerage company lists some of the suspect charities, including the Global Relief Foundation and Benevolence International Foundation, as grant recipients. Fidelity did not report the amount of money that it has distributed to these organizations in the past.

Nothing malicious has occurred, as far as the funds themselves are concerned. With tens of thousands of donors and a vast number of recommended charities, Fidelity's Charitable Gift Fund, Schwab's Fund for Charitable Giving, Vanguard's Charitable Endowment Program, and other such funds would face an enormous challenge if they tried to verify the legitimacy of every charity favored by donors. Certainly the investment houses could not have been expected to screen charities against government lists of suspected terrorist fronts before the lists themselves were issued. Still, the vulnerability of donor-advised funds to potential abuse is significant. The funds have provided only modest direction to donors regarding available information about recommended grant recipients. They have not thoroughly investigated the uses of their charitable grants. Nor have they offered much aid to unwitting supporters of alleged terrorist groups by helping them identify inappropriate grant recipients.

In explaining their operating style, the commercially run donor-advised funds have always emphasized the virtues of promoting the free flow of charitable dollars. But such freedom can come at the expense of thorough monitoring.

The fact that Fidelity had to develop a *post hoc* policy regarding the suspected terrorist fronts is consistent with that approach. For instance, the Justice Department froze assets of the Quranic Literacy Institute in 1998 following a very public allegation that the group was connected to the Palestinian terrorist group Hamas. Yet two years later Fidelity listed the group as one of its grant recipients.

Despite assertions to the contrary, it does not unfairly limit donors' freedom of choice to argue that the funds should take greater responsibility for their giving and exercise more control over disbursing the gifts they receive. Donors who want to avoid a fund's scrutinizing actions should donate directly to the tax-exempt organization of their choice – and incur the risk that the IRS may withdraw the tax-deductibility of their gift if the recipient is found to be a terrorist group.

The fact that groups such as Fidelity have begun monitoring government lists of suspected terrorist organizations is a positive development. However, using these lists alone could prove to be unfair to nonprofit groups that are subsequently cleared of wrongdoing. And the lists would not reflect the fact that information about misconduct by groups often becomes available before formal government action is appropriate.

Indeed, relying exclusively on government watch lists is not a substitute for exercising precautionary diligence. *The Wall Street Journal*, for example, observed that journalists publicized the FBI's investigation of the Holy Land Foundation's connection with the militant Palestinian group Hamas as early as 1994, and some donors no doubt ceased giving to that foundation as a result of their concern. Nonetheless, the Holy Land Foundation's tax return reflects that it raised $13.3 million in donations during the tax year 2000.

Outside the context of terrorism, observers have expressed fears that the funds' failure to monitor the use of grants may have allowed some donors to subvert the law by directing gifts to groups that benefited them personally, including their own private foundations.

While it is unreasonable to assume that funds affiliated with brokerage houses can prevent every instance of wrongdoing by donors or grant recipients, the funds could — and should — be doing more to prevent abuses. They should routinely provide research findings to donors about the integrity and financial efficiency of the organizations they are supporting. In addition, they should more aggressively assess donors' recommendations, using the best possible information on charities' operations. They should discourage donors from giving anonymously. And, to the extent they have not already done so, the funds should make the names of donors available to law enforcement officials.

Many have argued that brokerage-affiliated donor-advised funds serve their commercial self-interests better than they serve charities, donors or the public interest. As long as the problem seemed limited to self-dealing by some donors and mismanagement by some funds at the fringes of the nonprofit world, it was not a matter of extraordinary concern. However, now that the problem of terrorist front organizations has emerged, the stakes are higher. The way government monitors the activities of tax-exempt organizations, and the way the donor-advised funds conduct their charitable giving, is due for change.

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Norman Silber joined the Hofstra faculty in 1989 after practicing with the New York City law firm Patterson, Belknap, Webb & Tyler, and serving as a law clerk to Judge Leonard I. Garth of the U.S. Court of Appeals for the Third Circuit.

In addition to teaching and writing in areas that relate to consumer law, legal history, commercial law and nonprofit corporations, Professor Silber served as Vice Dean for the School of Law in 1999 and 2000. In 1997 he served as a visiting research professor at the School of Law at University of California at Berkeley.

Professor Silber earned a B.A. in history from Washington University, an M.A. and Ph.D. in history from Yale University, and a J.D. from Columbia University. Prior to entering law school, he taught history at Sarah Lawrence College and Yale University.

Professor Silber's most recent book, *A Corporate Form of Freedom* (Westview Press, 2001), presents a history of America's nonprofit sector. He is the author of a highly regarded book about consumer protection, *Test and Protest, The Influence of Consumers Union* (Holmes and Meier,1983), and he is currently working on two books, *Nonprofit Corporations: A Textbook* and *The Deliberate Activist: Philip Elman's Story of Civil Rights, Civil Liberties, and Consumer Law*. He has published in the *Harvard Law Review*, *Columbia Law Review*, *Pittsburgh Law Review* and other academic journals, and scripted a PBS television documentary about risk and consumer regulation.

Professor Silber is a past chair of the Association of the Bar of the City of New York Consumer Affairs Committee, a past director of the American Council on Consumer Interests, and past editor of *Advancing the Consumer Interest: A Journal of Consumer Law, Policy and Research*. Currently he serves as a director of Consumers Union and is the publisher of *Consumer Reports* magazine. He is a fellow of the American Bar Foundation. -SK