Occasional Paper

Regulating the Foreign Activities of Charities: A Comparative Perspective

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The Pemsel Case
FOUNDATION

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"The law of charity is a moving subject"
– Lord Wilberforce

About Us

Named after the 1891 House of Lords decision, *Commissioners for Special Purposes of the Income Tax v. Pemsel*, [1891] A.C. 531, which established the four principal common law heads of charity used in Canada and elsewhere, The Pemsel Case Foundation is mandated to undertake research, education and litigation interventions to help clarify and develop the law related to Canadian charities. The Pemsel Case Foundation is incorporated under the Alberta *Societies Act* and is a registered charity.

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Executive Summary

At common law, charities may carry out their charitable purposes overseas subject to conducting their work in a way that does not contravene law or public policy (in their home country or in the foreign jurisdiction in which they are operating). Restrictions on doing so largely stem from statutory or regulatory measures adopted by government to counter terrorism or prevent the misuse of charitable resources for non-charitable purposes.

The globalisation of charity and philanthropy has provided enormous challenges for governments in regulating the foreign activities of charities. As the subsector of charities operating internationally continues to evolve in the wake of new technologies and financing mechanisms used to transfer charitable funds across borders, along with the advent of terrorism challenges and global migration, it is critical for governments to re-examine their regulatory objectives for charities operating overseas and adjust their strategies accordingly.

This independent analysis, commissioned by the Pemsel Case Foundation, seeks to increase policymakers' understanding of the legal and regulatory measures undertaken in four common law jurisdictions – Canada, the United States, the United Kingdom and Australia – to regulate cross-border charitable work. The aim is to inform the Canadian Government should it decide to undertake reform of its legislative and regulatory framework governing the foreign activities of charities.

Key findings:

- Since the September 11 terrorist attacks, governments have proactively used an array of tools to regulate the foreign activities of charities.
    - Legislative measures include anti-terrorism legislation and geographic restrictions in the tax legislation.
    - Regulatory measures specifically targeting charities operating overseas include: registration and reporting requirements; control requirements; screening processes and contractual requirements for overseas aid grants; inquiries and audits; and guidance for charities working internationally.
- Self-regulation by peak bodies for the international aid and development sector is an important non-governmental tool used to review overseas charitable endeavours.
- Relative to the regulatory constraints in the other common law jurisdictions examined, the restrictions placed on Canadian registered charities operating outside Canada are particularly onerous, specifically:
    - Restrictive interpretation of the tax legislation by both the tax authorities and the courts;
    - Strict 'direction and control' requirements by the tax authorities; and
    - Rigorous enforcement through extensive tax audits.

List of Abbreviations

ACFID	Australian Council for International Development
ACNC	Australian Charities and Not-for-profits Commission
AIS	Annual Information Statement
ATO	Australian Taxation Office
AUSAid	Australian Agency for International Development
AUSTRAC	Australian Transaction Reports and Analysis Centre
CCIC	Canadian Council for International Cooperation
CIDA	Canadian International Development Agency
CRA	Canada Revenue Agency
DAC	Development Assistance Committee
DFAT	Department of Foreign Affairs and Trade (Australia)
DFID	Department for International Development (UK)
DGR	Deductible Gift Recipient (Australia)
ECJ	European Court of Justice
EU	European Union
FATF	Financial Action Task Force
FINTRAC	Financial Transactions and Reports Analysis Centre of Canada
HMRC	HM Revenue and Customs (UK)
INR8	Interpretive Note to Recommendation 8
IRS	Internal Revenue Service (US)
NFP/NPO	Nonprofit, or Not-for-profit, Organisation
NGO	Non-governmental Organisation
OAGDS	Overseas Aid Gift Deduction Scheme
OECD	Organisation for Economic Co-operation and Development
PBI	Public Benevolent Institution (Australia)
REO	Register of Environmental Organisations (Australia)
UK	United Kingdom
UN	United Nations
US	United States
USAID	United States Agency for International Development

Regulating the Foreign Activities of Charities: A Comparative Perspective*

Introduction

The common law has long recognised that charities may advance their purposes beyond the borders of their home jurisdiction. From the iconic charity case in 1891, *Commissioners for Special Purposes of Income Tax v Pemsel*,[1] which involved a charitable trust established in the United Kingdom to support and advance 'missionary activities among heathen nations', it has been broadly permissible for philanthropic trusts to carry out their charitable purposes in foreign lands. Constraints on doing so, therefore, largely stem from additional statutory or regulatory measures adopted by a charity's home jurisdiction.

As charities must act lawfully and cannot conduct themselves in ways that contravene public policy, what qualifies as charitable in different jurisdictions may vary in accordance with local law and regulation. For charities operating in foreign jurisdictions, there are two principal concerns for government that lead to restrictions: mitigating the risk of charities being misused for terrorist purposes and preventing the diversion of resources for non-charitable purposes. The importance of the latter frequently takes on an added dimension when a significant tax expenditure is available in the home jurisdiction to support the charity's work.

In an evolving global landscape where charitable endeavours are increasingly crossing national borders, governments must address the issue of how best to regulate the foreign activities of charities and their donors. In the century plus since *Pemsel*, the difficulties of redressing the misuse of charitable resources occurring in another jurisdiction (and any associated leakage from the tax base), has prompted many countries to implement interventionist, and often complicated, measures applied in the home jurisdiction to discourage or curtail opportunities for abuse once funds are transferred abroad. The approaches have been varied and are quite country-specific.

While the globalisation of charity has brought widespread benefits at home and around the world, following the September 11, 2001 terrorist attacks, governments have been concerned with the potential for international charitable work — like other cross-border transactions — to be diverted for the purposes of terrorism. In response to this potential threat, governments have introduced extensive additional and coordinated measures to regulate cross-border charity. At the same time, the Financial Action Task Force (FATF), an independent intergovernmental body that sets international standards and promotes implementation of measures for combating terrorist financing through its recommendations, introduced Recommendation 8 to address specific terrorist financing vulnerabilities and threats faced by the charitable sector. Recommendation 8 and its Interpretive Note (INR8) serve as an international policy standard that influences the domestic regulation of the foreign activities of charities.

More recently, FATF has acknowledged that the charitable sector's vulnerability to terrorist financing may have been overstated and that 'not all NPOs are inherently high risk (and some may represent little or no risk at all)'.[2] FATF subsequently revised Recommendation 8 and INR8 to

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[1] [1891] AC 531 (*Pemsel*).
[2] FATF, *International Standards on Combatting Money Laundering and the Financing of Terrorism and Proliferation: The FATF Recommendations*, February 2012 (OECD/FATF 2016) 56.

remove language stating that not-for-profit organisations (NFPs) [3] were 'particularly vulnerable' to terrorist abuse, recommending that countries should instead use 'focused and proportionate measures', commensurate to the risks identified by the country through a risk-based approach.[4] As a result, governments will need to re-assess their domestic regulation of charities operating overseas to ensure consistency with FATF's new approach. This presents an opportunity for a more mature regulatory approach that strikes an appropriate balance between curbing the potential terrorist threat, while minimising the regulatory burden on these charities and enabling legitimate cross-border charitable flows.

Regulation of the charitable sector, like regulation of the for-profit sector, can be broadly conceptualised as both preventing the occurrence of certain undesirable activities that may occur in the sector (a 'red light' concept) and enabling the sector to thrive (a 'green light' concept).[5] At the same time, regulation of the charitable sector can be distinguished from other sectors in that its primary objective is to preserve the public trust in charities and to protect the public purse from unintended consequences of the charitable tax concessions. For governments, the task becomes balancing prescriptive 'red light' regulation, primarily through legislative rules and other regulatory requirements to prevent the abuse of charities and misuse of charitable funds, while enabling 'green light' regulation through soft law regulatory instruments and self-regulation to enable the sector to flourish. By combining elements of both, government can realise the operational advantages of the latter, while retaining the enforcement benefits of the former. Applying these concepts to the regulation of the sub-sector of charities operating internationally requires the adoption of 'red light' measures to address the specific objectives of mitigating the risk of charities operating overseas being misused for terrorist financing and other criminal purposes. At the same time, regulatory objectives for this sub-sector necessarily include 'green light' measures to promote the efficient use of charitable resources and to facilitate legitimate cross-border charity.

To understand the current domestic regimes for the regulation of foreign charities, this report undertakes a comparative analysis to examine how governments in four OECD countries – Canada, the United States, the United Kingdom and Australia – have responded to the challenges and opportunities presented by a changed global landscape. In doing so, it seeks to address the problem of how best to regulate the foreign activities of charities. As a tool for reform, a comparative analysis enables a country's laws and regulations affecting the foreign activities of charities to be considered beyond domestic policymaking concerns, to take into account the realities of cross-border movements in an increasingly globalised world. In doing so, it takes the country comparison beyond parallel descriptions of the domestic regulations in the four jurisdictions, to providing a critical evaluation of those regulations in order to understand the solutions adopted in the different countries and the key international trends that have emerged.

Part I of the report explores the legal and regulatory frameworks in each of the four jurisdictions that govern the foreign activities of charities and their donors. Part II provides an evaluation of the findings of the comparative analysis to understand the spectrum of approaches adopted by the different countries to the problem of how to regulate international charitable endeavours in a changed global environment and to identify key trends common to some or all of the jurisdictions. Based on this analysis, Part III offers potential recommendations to Canadian policymakers and other stakeholders for reforming Canada's regulatory regime governing the foreign activities of charities.

[3] The term 'not-for-profit organisation' (NFP) will be used throughout this report interchangeably with 'nonprofit organisation' (NPO) and 'non-governmental organisation' (NGO).
[4] The Global NPO Coalition on FATF,' NPOs applaud important changes in Financial Action Task Force (FATF) policy – NPOs no longer considered "particularly" vulnerable' (Press Release, 29 June 2016).
[5] Robert Baldwin, Martin Cave and Martin Lodge, *Understanding Regulation: Theory, Strategy, and Practice* (Oxford, 2012) 4.

1. Legal and Regulatory Frameworks

This section examines the legal and regulatory framework affecting the foreign activities of charities in Canada, the United States (US), the United Kingdom (UK), and Australia. These countries are all present members of the OECD group of Development Assistance Committee's (DAC) donor countries and as such are all considered developed nations with high income and the most significant providers of overseas development aid. Together these countries contribute approximately 44% of total official development assistance.[6] They are all members of the Financial Action Task Force (FATF) and as such, are subject to regular periodic assessments of their compliance with FATF Recommendation 8 through a mutual evaluation process in which countries are rated by a team of experts as compliant, largely compliant, partially compliant, or non-compliant. Each of these countries also are at a similar level of evolutionary legal development, providing a functional equivalence that facilitates the comparative analysis.[7]

Importantly, these jurisdictions evidence a variety of approaches to the regulation of charities reflecting the historical and cultural context in which their regulatory regimes operate. Australia's approach is based on a statutory version of the common law definition of charity, with regulation occurring mainly through its fledgling national regulatory agency, the Australian Charities and Not-for-profits Commission, in conjunction with the Australian Tax Office. The UK similarly has codified the common law concept of charity, regulated by its longstanding charity regulator, the Charity Commission of England and Wales with an increasing regulatory role undertaken by the UK tax authority, HM Revenue and Customs. The United States and Canada, while maintaining the common law concept of charity, do not have a national regulatory agency and instead regulate charities primarily through their federal tax authorities, the Internal Revenue Service and the Canada Revenue Agency.

Each jurisdiction's legal and regulatory framework impacting the work of charities operating overseas will be examined under three headings: (1) legislative measures; (2) regulatory measures, both government-mandated mechanisms and sector-driven self-regulation;[8] and (3) jurisprudence. This provides a thematic basis for comparison, augmenting the functional equivalence of the four jurisdictions.

1.1 Canada

In Canada, the regulation of charities is primarily undertaken by the Charities Directorate of the Canada Revenue Agency (CRA).[9] Global Affairs, the government department responsible for Canada's international development and humanitarian assistance, is also involved in the regulation of Canadian charities undertaking development and relief work outside Canada. In addition to governmental regulation, oversight of organisations engaged abroad also takes place via self-regulation through the Canadian Council for International Cooperation (CCIC) and to a lesser extent, Imagine Canada.

The most recent evaluation by the Financial Action Task Force (FATF) in 2008 found that Canada was largely compliant with Recommendation 8, a result of the CRA having taken 'considerable steps to implement [Recommendation 8] in relation to registered charities' through its

[6] Data is from 2013. See OECD, *Development Co-operation Report 2015*, Table A.1 <www.oecdilibrary.org/development/development-co-operation-report-2015_dcr-2015-en>.
[7] See Konrad Zweigert and Hein Kötz, *Introduction to Comparative Law* (Oxford University Press, 3rd ed, 1998) 34.
[8] Many international development organisations also self-regulate through international bodies, including Active Learning Network for Accountability and Performance in Humanitarian Action (ALNAP), Humanitarian Accountability Partnership (HAP), People in Aid, and the Sphere Project.
[9] While constitutional authority for charities is provided to the provinces, they have been 'largely uninterested'. See Susan Phillips, 'Canadian Leapfrog: From Regulating Charitable Fundraising to Co-Regulating Good Governance' (2012) 23 *Voluntas* 808, 810.

registration and reporting requirements, extensive information collection regime for all nonprofits for tax purposes and comprehensive field audits.[10]

This section examines the legislative and regulatory measures employed to regulate Canadian charities engaged in international charitable endeavours.

1.1.1 Legislative Measures

Anti-terrorism Legislation

In response to the September 11 terrorist attacks and their Canadian precursor, the Air India Bombings which took place in 1985 on a flight from Vancouver, the Canadian Government introduced significant counter-terrorism legislation. This included the *Anti-Terrorism Act of 2001*,[11] which resulted in the strengthening of counter-terrorism provisions in Canada's *Criminal Code*[12] and the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act (Proceeds of Crime Act)*.[13] The *Anti-Terrorism Act* also included the *Charities Registration (Security Information) Act,*[14] establishing a mechanism to deny or revoke registration of charitable status if there are reasonable grounds to conclude the charity has operated to make its resources available to an organisation or person that engages in or supports terrorist activities.

Tax Legislation: 'In Canada' Residency Requirement for Charitable Status and Tax Relief

The CRA makes determinations of charitable status under Canada's *Income Tax Act* (*ITA*).[15] An organisation whose purposes and activities are charitable (as defined in the common law), may apply to the CRA to become a registered charity. Registered charities are entitled to income tax exemption and are 'qualified donees' under the *ITA*, enabling them to issue official donation receipts to corporations and individual donors who are then entitled to receive a tax concession for their gifts.[16]

In Canada, foreign-based entities cannot be registered as charities because there is an 'in Canada' residency requirement contained in the definition of registered charity in the *ITA*, which states that a charity must be 'resident in Canada and was either created or established in Canada'.[17] In some limited circumstances, foreign entities may be eligible to be 'qualified donees' and afforded similar treatment to Canadian registered charities,[18] however these instances are rare.

Additionally, the *ITA* defines a charitable organisation as having 'all [of its] resources devoted to charitable activities carried on by the organization itself'.[19] The CRA has determined that this provision means that charitable organisations can only use their resources overseas through gifts

[10] FATF, *Third Mutual Evaluation Report on Anti-Money Laundering and Combatting the Financing of Terrorism– Canada* (2008) 254–9.
[11] *Anti-Terrorism* Act, SC 2001, c 41.
[12] *Criminal Code, RSC 1985*, c C-46.
[13] *Proceeds of Crime (Money Laundering) and Terrorist Financing Act (Proceeds of Crime Act),* SC 2000, c 17.
[14] *Charities Registration (Security Information) Act,* SC 2001, c 41, s 4(1)(a).
[15] *Income Tax Act*, RSC 1985, c 1 ('*ITA*'). Registered charities can be subject to other federal or provincial/territorial legislation that is associated with their operations, including provincial, territorial, or municipal laws governing fundraising and other operations of the charity.
[16] See *ITA* s 149.1(1) which defines 'qualified donee'. For individuals, the tax concession for a charitable donation is in the form of a tax credit. A list of qualified donees is maintained by the CRA and is publicly available. See Canada Revenue Agency, *Charities Listings* <http://www.cra-arc.gc.ca/chrts-gvng/lstngs/menu-eng.html>.
[17] *ITA* s 248(1).
[18] Prescribed foreign universities and foreign organisations that have received a gift from the Canadian Government are able to receive 'qualified donee' status under *ITA* ss 149.1(1)(a)(iv) and (v) in the definition of a qualified donee, respectively. The latter lasts for a 24-month period during which the organisation is on a publicly available list of foreign qualified donees maintained by the CRA. At the time of writing, three organisations appeared on this approved foreign charity list. In addition, Canada has an income tax treaty with the US, which treats certain US charities as qualified donees, although tax relief is only available against Canadian taxes on US source income. See *Convention with Respect to Taxes on Income and on Capital*, United States–Canada, signed 26 September 1980, 1980 UTS 93 (entered into force 16 August 1984) art XXI.
[19] *ITA* s 149.1(1).

to 'qualified donees' or by carrying on their 'own activities', which requires meeting significant 'direction and control' requirements over the use of funds.[20] As a result, Canadian charities can only operate outside Canada through their 'own activities', which requires: (1) using their own staff (including volunteers, directors, or employees); or (2) through an intermediary (such as a foreign charity that serves as an agent, contractor or joint venture partner), provided that they exercise 'direction and control' over the resources, as discussed below.[21]

The CRA has also determined that when a Canadian registered charity sends charitable funds overseas, it is not permitted to serve as a mere conduit, whereby it receives tax deductible donations from individuals or charities and then funnels money without 'direction or control' to a foreign charity to which a Canadian taxpayer could not make a gift and receive a tax concession.[22]

1.1.2 Regulatory Measures

A. Government Regulation

CRA: Registration, Guidance, 'Direction and Control' Requirement, Recordkeeping, Reporting Requirements and Audits

To apply for registration an organisation must provide the CRA with a detailed description of its charitable work, financial information and information about its officials, as well as the organisation's governing documents and financial statements.[23] As part of the review process, the CRA ensures that organisations comply with Canada's anti-terrorism legislation. Under the *Charities Registration (Security Information) Act*,[24] the CRA may deny (or once registered, revoke) registration of charitable status if there are reasonable grounds to conclude the organisation has made its resources available either directly or indirectly to further terrorism.[25] The CRA works in collaboration with Financial Transaction and Reports Analysis Centre of Canada (FINTRAC) to identify suspected cases of terrorist financing involving charities,[26] and has produced guidance to help Canadian charities identify vulnerabilities to terrorist abuse.[27]

The CRA requires that a registered charity take all necessary measures to 'direct and control' the use of its resources when carrying out charitable work through an intermediary, and maintain a record of steps taken to 'direct and control' the use of its resources to enable the CRA to verify that all of the charity's resources have been used for its own activities.[28] These steps include:

- Conducting due diligence to ensure that the intermediary has the capacity to carry out the charity's activity;
- Creating a written agreement with the intermediary and implementing its terms;

[20] Canadian public and private foundations are defined without an equivalent 'all the resources' clause, but are subject to penalties where they make gifts to entities that are not qualified donees. The question of what, if any, 'direction and control' requirements are necessary if Canadian foundations carry on activities abroad has not yet been dealt with by the courts.
[21] See Canada Revenue Agency, *Canadian Registered Charities Carrying Out Activities Outside Canada* (CG-002, July 8, 2010) <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/tsd-cnd-eng.html>.
[22] See Canada Revenue Agency, *Canadian Registered Charities Carrying Out Activities Outside Canada* (CG-002, July 8, 2010) [5.5] <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/tsd-cnd-eng.html>.
[23] See <http://www.cra-arc.gc.ca/chrts-gvng/chrts/pplyng/htply-eng.html>.
[24] *Charities Registration (Security Information)* Act, SC 2001, c 41, s 4(1)(a).
[25] See Canada Revenue Agency, *Charities in the International Context* <http://www.cra-arc.gc.ca/chrts-gvng/chrts/ntrntnl-eng.html>.
[26] See FATF, *Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism – Canada* (2008) 257.
[27] Canada Revenue Agency, Checklist for Charities on Avoiding Terrorist Abuse <http://www.cra-arc.gc.ca/chrts-gvng/chrts/chcklsts/vtb-eng.html>; Canada Revenue Agency, *Charities in the International Context* <http://www.cra-arc.gc.ca/chrts-gvng/chrts/ntrntnl-eng.html>.
[28] See Canada Revenue Agency, *Canadian Registered Charities Carrying Out Activities Outside Canada* (CG-002, July 8, 2010) <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/tsd-cnd-eng.html>.

- Communicating a clear, complete, and detailed description of the activity to the intermediary;
- Monitoring and supervising the activity in order to receive timely and accurate reports;[29]
- Providing clear, complete, and detailed instructions to the intermediary on an ongoing basis;[30]
- Arranging for the intermediary to keep the charity's funds separate from its own, and to keep separate books and records; and
- Making periodic transfers of resources in instalments based on the intermediary's demonstrated performance.

The 'direction and control' measures also require that a Canadian registered charity keep adequate books and records in Canada of its overseas activities to ensure the CRA can verify that (1) a charity's funds are being spent on its own activities or on gifts to qualified donees, and (2) the charity is directing and controlling the use of its resources. Generally, the CRA requires books and records to be kept for a minimum of six years.[31] The CRA further requires that the charity get original source documents whenever possible (or to explain why it cannot) and translate those documents into French or English. Failure to exercise 'direction and control' risks sanctions under the *ITA*, including financial penalties and revocation of registered status.[32]

An exception to the 'direction and control' requirement exists where a registered Canadian charity transfers property (which does not include money) directly to a non-qualified (foreign) donee where 'the nature of the property being transferred is such that it can reasonably be used only for charitable purposes'.[33] Examples include medical supplies for a hospital overseas, or food and blankets for a foreign charity engaged in disaster relief. This exception, known as the 'charitable goods policy', requires that both parties understand and agree the property is to be used only for the specified charitable endeavours and the charity has a 'strong expectation' that the organisation will use the property only for the intended charitable work based on due diligence it has carried out on the intermediary. The result is that there is no continuing obligation for the charity to exercise 'direction and control' over the donated goods. This policy has proven to be quite limited in application, as described below under jurisprudence.

Registered charities are required to file an annual information return, with detailed information on overseas activities.[34] When reporting expenditures on the return, all amounts spent on a charity's activities outside Canada (either directly or through intermediaries) are to be reported, including the countries in which the activities were carried out.[35] The charity is also required to provide information about foreign donors for gifts of $10,000 or more, including the identity of

[29] Depending on the size, nature and complexity of an activity, this may include: progress reports; receipts for expenses and financial statements; informal communication via phone or email; photographs; audit reports; and on-site inspections by the charity's staff members.
[30] This includes such things as minutes of meetings or other written records of decisions showing the charity has given instructions.
[31] See <http://www.cra-arc.gc.ca/records/>.
[32] *ITA* s 168(1)(e).
[33] See Canada Revenue Agency, *Canadian Registered Charities Carrying Out Activities Outside Canada* (CG-002, July 8, 2010) [5.2] <http://www.cra-arc.gc.ca/chrtsgvng/chrts/plcy/cgd/tsd-cnd-eng.html>.
[34] See *ITA* s 149.1(14). This is the Form T3010, Registered Charity Information Return <http://www.cra-arc.gc.ca/E/pbg/tf/t3010/t3010-16e.pdf>.
[35] See *Schedule 2: Activities Outside Canada* See <http://www.cra-arc.gc.ca/E/pbg/tf/t3010/t3010-16e.pdf>.

the donor and the amount of the gift.[36] Failure to provide a return may result in revocation of charitable status at the discretion of the CRA.[37]

As part of its ongoing efforts to make sure charities meet the requirements of registration, the CRA audits about 1% of charities per annum, which translates into approximately 800-900 registered charities across Canada each year.[38] Charities may be selected for an audit based on a number of criteria, including review of their legal obligations under the *ITA*, information from their annual returns, media coverage and public complaints. CRA audits sharply increased following the discovery in 2007 that charities were being used as tax shelters.[39] If an audit raises concerns, compliance measures include: education letters informing the charities how to become fully compliant; compliance agreements outlining areas of non-compliance and committing charities to take corrective action; sanctions such as financial penalties and temporary suspensions of tax-receipting privileges and qualified donee status; and revocation of charitable registration.[40] Approximately 10 registered charities per year have their charitable status revoked as a result of serious non-compliance issues, including those that 'failed to demonstrate sufficient control over their foreign operations'.[41]

Global Affairs: NGO Institutional Profile and Contractual Requirements in Grant Agreements

Global Affairs, formerly Foreign Affairs, Trade and Development Canada (DFATD), provides funding to NGOs for humanitarian assistance to developing countries. To be eligible for funding, an organisation must first submit an NGO Institutional Profile to Global Affairs for review, demonstrating through supporting documentation that it meets 10 minimum requirements, including registration as a non-profit organisation, measures addressing Canada's anti-terrorism legislation, adherence to international codes of conduct, and financial and operational requirements.[42] In order to maintain their eligibility for funding, NGOs are required to update their profile every three years. Funding is provided through a contribution, or grant, agreement, which contains reporting requirements and other provisions for monitoring and compliance.[43]

B. Self-regulation

CCIC: Code of Ethics and Operational Standards

The Canadian Council for International Cooperation (CCIC) is the peak body for Canadian NFPs involved in social justice, international development and humanitarian action, with approximately 80 CCIC members. CCIC has developed a code of ethics and operational standards with which its members must comply (the *'Code'*).[44] The Code represents a voluntary, self-regulatory code of good practice, which aims to increase transparency and accountability and encourage effective regulation. This is achieved through annual self-assessments and the submission of a renewal of compliance every three years, in which members must provide CCIC with certification from its governing body of full compliance or an explanation of non-compliance. A member organisation is

[36] See *Schedule 4*, Part 2: Information about donors not resident in Canada <http://www.craarc.gc.ca/formspubs/prioryear/t4033/t4033-15e.pdf>.
[37] *ITA* 168(1)(c).
[38] See <http://www.cra-arc.gc.ca/chrts-gvng/chrts/dtng/dt-prcss-eng.html>.
[39] Susan Phillips, 'Shining Light on Charities or Looking in the Wrong Place? Regulation-By-Transparency in Canada' (2013) 24 *Voluntas* 881, 897.
[40] See <http://www.cra-arc.gc.ca/chrts-gvng/chrts/dtng/dt-prcss-eng.html>.
[41] See FATF, *Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism – Canada* (2008) 256.
[42] DFATD, *International Humanitarian Assistance: Funding Application Guidelines for Non-governmental Organizations* (2 October 2014) <http://www.international.gc.ca/development-developpement/assets/pdfs/funding-financement/funding-application-guidelines-for-non-governmental-organizations-eng.pdf>.
[43] See <http://www.international.gc.ca/development-developpement/partners-partenaires/bt-oa/contribution_general-accord_general.aspx?lang=eng>.
[44] See <http://www.ccic.ca/about/ethics_e.php>.

expected to reach full compliance, unless the explanation provided satisfies CCIC that the organisation remains committed to ethical conduct but has an adequate reason for not fulfilling a particular standard of practice.

Imagine Canada: Standards Program

Imagine Canada is the national umbrella organisation for the charitable sector. Since 2012, Imagine Canada has had a Standards Program, which was preceded by an Ethical Code Program dating from the late 1990s that focused on fundraising and financial accountability. The Standards Program is more than a voluntary code of conduct; it awards accreditation for five years though a peer review process for Canadian charities and public benefit nonprofits that commit to abiding by reputable policies and practices in five areas: board governance, financial accountability and transparency, fundraising, staff management, and volunteer involvement.[45] An annual compliance report and license fee must be submitted to maintain accreditation. Compliance is also monitored through investigation of complaints and accredited organisations being subject to audits under the program. There are, as of this writing, approximately 210 accredited organisations participating in this program.

1.1.3 Jurisprudence

Four decisions by the Federal Court of Appeal have had important implications for the regulation of international charitable endeavours.[46] These cases have determined that a charity working with an intermediary to carry out activities overseas must 'direct and control' the use of its resources and cannot serve as a mere conduit to funnel donations overseas. As stated by the Court in *Canadian Committee for the Tel Aviv Foundation v Canada*, this requires that the charity satisfy the CRA that 'it is at all times both in control of the [intermediary], and in a position to report on the [intermediary]'s activities.'[47] Each case was an appeal of a revocation of charitable status by the CRA on the basis that the charity failed the 'own activities' test by not demonstrating that it met all of the requirements of maintaining 'direction and control' over its foreign intermediaries. The Court of Appeal dismissed each case on the basis that it was reasonable for the CRA to determine that the 'direction and control' requirements were not met.

The most recent case was *Public Television Association of Québec v Canada (National Revenue)* ('*Public Television*')[48] where the Public Television Association of Québec (PTAQ), a registered charity, carried out charitable work through Vermont Public Television (VPT), a US 501(c)(3) organisation pursuant to broadcasting and fundraising agreements. The CRA revoked PTAQ's charitable registration on the basis that PTAQ was not carrying on its own activities with VPT as its agent, but instead was merely a conduit for VPT to issue receipts for donations from Canadian donors. The Court upheld the revocation, finding that PTAQ was serving as a conduit for VPT because it failed to exercise appropriate 'direction and control' over its resources. [49]

Imagine Canada was an intervener in the *Public Television* case. It argued that the type and level of 'direction and control' required by the CRA exceeds that required under the *ITA*, leading to unnecessary administrative and legal expense and constituting a significant impediment to Canadian charities carrying on charitable endeavours abroad. Specifically, the intervener argued that

[45] See <http://www.imaginecanada.ca/about-standards-program>.
[46] *Canadian Committee for the Tel Aviv Foundation v Canada* [2002] FCA 72; *Canadian Magen David Adom for Israel v Canada* (Minister of National Revenue) [2002] FCA 323; *Bayit Lepletot v Canada* (Minister of National Revenue) [2006] FCA 128; *Public Television Association of Québec v Canada (National Revenue)* [2015] FCA 170.
[47] [2002] FCA 72 [40].
[48] [2015] FCA 170.
[49] *Public Television* 24 [55].

> the 'own activities' requirement should not be interpreted to restrict a charity to the conduct of activities through employees and agents, or through joint ventures, partnerships or contracts. The statutory language does not explicitly mention these legal forms or institutions, so it should not be interpreted as requiring them.[50]

Instead, Imagine Canada argued that 'direction and control' is satisfied 'by requiring charitable fiduciaries to take appropriate measures to ensure that charitable resources deployed abroad remain devoted to exclusively charitable purposes'.[51] This requires that 'the charitable outcomes achieved are planned and intended by the fiduciaries of the charitable organization and the fiduciaries of the charitable organization are confident that sufficient measures have been taken to ensure that they are achieved', with the charity providing evidence of where and how its funds are spent by its intermediary and to report on such spending.[52]

The intervention argument was closely tied to what is known in Canada as the 'charitable goods policy'. This policy is described in CRA guidance and an earlier version was referred to in the case of *Canadian Magen David Adom for Israel v Canada (Minister of National Revenue)* ('*Magen David*').[53] It states that the nature of some goods (for example, religious texts or medical supplies) is such that there is a presumption that those goods will be used for charitable purposes. In *Magen David*, the charitable goods policy was interpreted strictly by the Court. The Court found that while the Minister of National Revenue had taken the position in the past that the appellant's provision of ambulances and equipment to an Israeli organisation was within the charitable goods policy, the current evidence did not support a 'reasonable expectation' that the ambulances and equipment provided by the appellant to the organisation in Israel were used only for charitable purposes and consequently, the charitable goods policy did not apply.

1.1.4 Summary of Legal and Regulatory Framework

The 'in Canada' residency requirement contained in Canada's tax legislation, as interpreted by the CRA and the Courts, has served as a 'red light' tool for regulating the ability of Canadian charities and their donors to engage in international charitable endeavours. While Canadian registered charities are able to operate overseas, the CRA's strict 'red light' control requirement imposes considerable administrative burdens on charities, which serves as a disincentive for smaller charities to engage in activities abroad. For those that choose to undertake overseas charitable work, the significant compliance costs involved in meeting the 'direction and control' requirement deplete vital funds that could otherwise be used to help communities outside Canada. The charitable goods policy provides a limited exception to the 'direction and control' requirement, while offering the possibility of an alternative, less onerous test for regulating the foreign activities of Canadian charities that adheres the *ITA's* 'in Canada' residency requirement.

In its most recent evaluation of Canada, FATF commended the CRA on the steps it had taken to implement Recommendation 8, including registration and reporting requirements providing detailed information on cross-border activities and donations, extensive guidance for charities operating overseas, and a comprehensive auditing program.

For the larger international aid charities, 'green light' regulation occurs through an initial screening process and contractual requirements with Global Affairs providing an additional layer of ongoing regulation, while those that are members of CCIC or participating in Imagine Canada's Standards Program are subject to mandatory self-assessment and accreditation, respectively.

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[50] *Public Television*, Summary of the Intervener's Oral Argument (Court File No. A-406-13) para 3(b)(i).
[51] *Public Television*, Summary of the Intervener's Oral Argument (Court File No. A-406-13) para 3(f)(i). See also paras 3(c)(i) and (ii).
[52] *Public Television*, Summary of the Intervener's Oral Argument (Court File No. A-406-13) para 3(c)(iv).
[53] [2002] FCA 323 [71]–[74].

However, there appears to be little overt coordination among these regulatory agencies, so this 'green light' regulation is not generally used as a proxy for compliance with registered charity regulation under the *ITA* or for conformity with anti-terrorism measures.

1.2 United States

The regulation of charities in the US is primarily undertaken by the US tax authority, the Internal Revenue Service (IRS), which serves as the de facto charity regulator. The US Treasury has also taken an active role in the foreign activities of charities through its Office of Foreign Assets Control. The United States Agency for International Development (USAID) is involved in the regulation of certain US charities undertaking development and relief work outside the US. In addition to governmental regulation, oversight of organisations engaged abroad also takes place via self-regulation through InterAction.[54]

The most recent evaluation by the Financial Action Task Force (FATF) in 2006 found the US to be compliant with Recommendation 8 as a result of the adoption of specific anti-terrorism measures, as well as the extensive registration and reporting requirements.[55] Despite this finding, the report cited a comparative study, which found that the IRS has had difficulty monitoring the large number of charitable organisations under its supervision resulting in 'a lightly regulated industry'.[56]

This section examines the legislative and regulatory measures employed to regulate US charities engaged in international charitable endeavours.

1.2.1 Legislative Measures

Anti-terrorism Legislation

In response to the terrorist attacks of September 11, the Federal Government quickly introduced significant counter-terrorism legislation, including *Executive Order No 13,224*, [57] *Blocking Property and Prohibiting Transactions With Persons Who Commit, Threaten to Commit, or Support Terrorism* and the *US Patriot Act*,[58] which contains penalties for organisations which knowingly provide support for foreign terrorist groups. This built upon existing counter-terrorism statutes, notably the *Antiterrorism and Effective Death Penalty Act*,[59] which criminalised individuals who knowingly provided material support or resources to foreign terrorist organisations. The *Internal Revenue Code (IRC)* [60] was also amended to provide consequences for entities recognised as a terrorist organisation or a supporter of terrorism.[61]

Tax Legislation: 'In United States' Residency Requirement for Deductibility of Charitable Contributions

The IRS makes determinations of charitable status under the *IRC*. Section 501(c)(3) of the IRC defines charitable organisations as those 'organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international

[54] Independent Sector, the network for leaders of America's charitable and philanthropic sector, also provides guidance to its member organisations through its *Principles for Good Governance and Ethical Practice*. See <https://independentsector.org/principles>.
[55] FATF, *Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism: United States of America* (2006) 240–250.
[56] See FATF, *Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism: United States of America* (2006) 250, citing International Committee on Fundraising Organizations (May 2002).
[57] 66 Federal Regulation 49 079 (23 September 2001).
[58] *Uniting and Strengthening America by Providing Appropriate Tools Required To Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001*, Pub L No. 107–56, 115, Stat 272 18 USC § 2339A(a) (Supp IV 2004).
[59] *Antiterrorism and Effective Death Penalty Act of 1996*, Pub. L. No. 104-132, § 303(a).
[60] *Internal Revenue Code of 1986* (US) ('*IRC*'), as amended.
[61] *IRC* § 501(p).

amateur sports competition, or for the prevention of cruelty to children or animals'. [62] There are two classes of charitable organisations: public charities and private foundations, [63] with the former classified as such on the basis of its broader base of public support. Charitable organisations are exempt from income tax and can apply to the IRS to be 'qualified organisations' under the *IRC*, enabling them to issue official donation receipts to corporations and individual donors who are then entitled to receive a tax deduction for their gifts.[64] A qualified organisation may conduct part or all of its activities outside the US.[65]

While foreign organisations can qualify as a charity under section 501(c)(3) and be entitled to income tax exemption, in order to be eligible to receive tax deductible contributions, the charity must be 'created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States'. [66] This 'in United States' residency requirement means that foreign charities are not able to obtain 'qualified organisation' status and thereby receive tax deductible contributions from US donors.[67]

The IRS has interpreted this 'in United States' residency requirement for deductibility to allow a US charity to use tax deductible funds to conduct charitable programs abroad and make gifts to foreign charities in furtherance of its charitable purposes. [68] The IRS also permits a US charity to re-donate the tax deductible funds it receives to a foreign charity, provided that the funds are not 'earmarked' for the particular use or benefit of the specific foreign charity.[69] This requires the US charity to exercise proper 'control and discretion' over the funds meaning that the US charity must approve the use of funds as furthering its own charitable purposes and maintain control over the use of the donated funds by exercising an appropriate level of scrutiny over the foreign donee to ensure that it is an eligible charity within the meaning of section 501(c)(3).[70] The 'control and discretion' requirement means that the US charity must demonstrate that it can make an independent decision about whether it will provide funds to the foreign charity rather than being subject to the donor's direction. This is achieved through review and approval of all grants by the board and including provisions in the charity's bylaws stating that the board retains 'control and discretion' over funds contributed to the charity. The US charity should also be able to demonstrate that it has conducted due diligence to be reasonably sure that the grant will be used for exempt purposes, has entered into a written agreement regarding the use of funds, and has conducted appropriate monitoring through grant reports to show that the funds were used for approved exempt purposes.[71]

In accordance with the 'control and discretion' requirement, the IRS has stated that a US charity must not act as a 'mere conduit' in which funds have come to 'rest momentarily' before being

[62] *IRC* § 501(c)(3). For the purposes of this chapter, the terms '501(c)(3) organisation', 'US charity' and 'US charitable organisation' are used interchangeably.
[63] *IRC* § 501(c)(3). They are further classified as corporations, trusts, funds or community chests.
[64] *IRC* § 170. Gifts to non-charitable organisations are generally not deductible, other than war veterans' organisations, nonprofit cemetery companies and fraternal societies that use the gifts for charitable purposes. See *IRC* § 170(c).
[65] Treasury Regulations § 1.170A-8(1).
[66] *IRC* § 170(c)(2)(A). Emphasis added. Note that this limitation does not apply to gift and estate tax charitable deductions. See Harvey Dale, 'Foreign Charities' (1995) 48(3) *Tax Lawyer* 655, 668–70 for a detailed discussion of these provisions.
[67] Under US income tax treaties with Canada, Mexico and Israel, charities in these countries may be deemed to be qualified organisations if they meet certain conditions. See *Convention with Respect to Taxes on Income and on Capital*, United States–Canada, signed 26 September 1980, 1980 UTS 93 (entered into force 16 August 1984) art XXI; *Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income*, United States–Mexico, Treaty Doc No 103-7 (1992) (signed and entered into force 18 September 1992) art 22; *Convention with Respect to Taxes on Income*, United States–Israel, signed 20 November 1975, Exec Doc No 94-2 (1975) (entered into force 1 January 1995) art 15A.
[68] Treasury Regulations s 1.170A-8(a)(1). See also Revenue Ruling 63-252, 1963-2 CB 101.
[69] Revenue Ruling 63-252, 1963-2 CB 101; Revenue Ruling 66-79, 1966-1 CB 48. See also IRS Publication 526, *Charitable Contributions* (January 2016) 6 <https://www.irs.gov/pub/irs-pdf/p526.pdf>. Contributions to qualified charities may, however, be earmarked for flood relief, hurricane relief or other disaster relief.
[70] Revenue Ruling 66-79, 1966-1 CB 48. See also IRS Publication 526, *Charitable Contributions* (January 2016) 6 <https://www.irs.gov/pub/irs-pdf/p526.pdf>.
[71] See IRS, *International Activities of Domestic Charitable Organizations* (Video Transcript, August 2011) 5, 10 <http://www.irsvideos.gov/InternationalActivitiesDomesticCharitableOrgs/files/Transcript.pdf>.

passed along to a foreign donee designated by a donor.[72] However the IRS does allow a deduction where the intermediary US-based charity is specifically formed to provide funds to a particular foreign charity, commonly known as a 'friends of' organisation, provided the US charity exercises 'control and discretion' over the funds.[73]

If the charitable organisation engaged in international grantmaking is a private foundation, stricter rules apply to ensure that the funds are used for legitimate charitable purposes.[74] These include a requirement that one of two due diligence methods — expenditure responsibility or equivalency determination — is used to make grants overseas.[75] Expenditure responsibility (typically used for short term or one-time grants) requires that the foundation obtain assurance through a pre-grant enquiry that the foreign charity can fulfil the purpose of the grant as specified in a written grant agreement. The grant agreement should impose responsibilities on the grantee to: repay any grant funds not expended for the purposes of the grant; maintain the funds in a separate account or separate fund for charitable purposes; maintain records of receipts and expenditures for at least four years after the funds have been used and to make these records available to the grant-maker; and provide periodic reports from the grantee providing a detailed account of how the funds were used and a description of how the grantee is achieving the grant's purposes.[76] Equivalency determination requires that the foundation make a good faith determination that the foreign charity is equivalent to a 501(c)(3) organisation,[77] by obtaining written advice from a qualifying tax practitioner or an affidavit from the foreign charity.[78] The affidavit should include copies of the organisation's governing documents and describe the organisation's purposes and past and planned activities. It must be written in English, and an English translation must be provided for any supporting documents and a copy of the affidavit must be kept by the foundation and made available to the IRS upon request.[79]

1.2.2 Regulatory Measures

A. Government Regulation

IRS: Registration, Recordkeeping, Reporting Requirements, Guidance, Compliance Checks and Audits

The IRS determines whether an organisation meets 501(c)(3) status and issues a determination letter upon approval.[80] As part of the registration application, organisations must submit their governing documents, a description of all past, present and planned activities, and four years of financial statements.[81] As part of the review process, organisations engaged in international activities may be asked for additional information in order to make a determination, including: identifying the specific countries (and regions within the countries) in which the charity operates and describing their operations in each country; the extent to which the organisation is in compliance with the Office of Foreign Assets Control to ensure that foreign expenditures or

[72] Revenue Ruling 63-252, 1963-2 CB 101.
[73] Revenue Ruling 66-79, 1966-1 CB 48; Revenue Ruling 74-229, 1974-1 CB 142.
[74] See *IRC* § 4940–4948, which were added in 1969. For a discussion of these rules, see Harvey Dale, 'Foreign Charities' (1995) 48(3) *Tax Lawyer* 655, 680–684.
[75] See *IRC* s 4945(d); Treasury Regulations § 53.4945-5(a)(5).
[76] *IRC* § 4945(h); Treasury Regulations § 53.4945. See also IRS, *International Activities of Domestic Charitable Organizations* (Video Transcript, August 2011) 13 <http://www.irsvideos.gov/InternationalActivitiesDomesticCharitableOrgs/files/Transcript.pdf>.
[77] *IRC* § 4942; Treasury Regulations s 53.4942-3.
[78] IRS Revenue Procedure 92-94, 1992.
[79] See IRS, *International Activities of Domestic Charitable Organizations* (Video Transcript, August 2011) 5, 12 <http://www.irsvideos.gov/InternationalActivitiesDomesticCharitableOrgs/files/Transcript.pdf>.
[80] *IRC* § 508; Treas. Reg. § 1.508-1.
[81] See IRS Publication 557, *Tax-Exempt Status for Your Organization* (February 2016) <https://www.irs.gov/pub/irs-pdf/p557.pdf>.

grants are not diverted to support terrorism or other non-charitable endeavours; and detailed information on overseas grants such as how the organisation will exercise control and responsibility over the use of any funds or goods granted to foreign organisations or individuals.[82]

Once registered, all charities must adhere to the IRS' record keeping rules and reporting requirements. All charities must keep accounting records and supporting documents for a minimum of three years.[83] Charities (other than religious charities) must file annual IRS information returns, known as Form 990s.[84] Form 990s require information on cross-border charitable endeavours including: whether the organisation had an interest in a financial account in a foreign country (Part V, line 4A); maintained an office, employees, or agents outside the US (Part IV, lines 14a, 14b); and/or had aggregate revenues or expenses of more than $10,000 from grantmaking, fundraising, business, investment, and program service activities outside the US (Part IV, line 14b). Charities are required to list expenditure for grants and other assistance to foreign organisations, individuals or governments (Part IX, line 3) and specify whether the organisation reported more than $5,000 of grants or other assistance to or for any foreign organisations or individuals (Part IV, lines 15, 16).[85] Organisations that answer affirmatively to Part IV, line 14b, 15, or 16 are then required to complete Schedule F, which requires detailed information on activities conducted outside the US. [86] There are penalties for failure to file and not filing for three years results in automatic revocation of an organisation's 501(c)(3) status.[87]

In its guidance to US charities engaged in foreign activities, the IRS provides information on compliance with the Treasury Department's Office of Foreign Assets Control (OFAC), which has a country-based sanctions programs that prohibits a broad range of activities in or with a specific country and a list-based program that forbids transactions with specific individuals and organisations.[88] These include following *US Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S. Based Charities*[89] which provide due diligence measures for US charities and funders giving overseas and consulting OFAC's Specially Designated Nationals' list of individuals and organisations that have been linked to the funding of terrorist activities abroad. [90] While the Anti-Terrorist Financing Guidelines are voluntary in theory, 'in practice American non-profits faced a real risk of investigation or even prosecution for failing to carry out the due diligence that the guidelines detailed'.[91] As a result, some charities restricted their overseas activities and giving, particularly in conflict zones, while others shifted the risks onto foreign partners. In 2012, the Department of the Treasury and the IRS proposed rule changes aimed at reducing the legal barriers and administrative costs associated with cross-border philanthropy.[92] These regulations led to the establishment of NGOsource in 2013, an organisation that maintains a database of

[82] IRS, *Sample Questions: International Activities* <https://www.irs.gov/charities-non-profits/charitable-organizations/exempt-organization-sample-questions-international-activities>.
[83] See IRS Publication 4221-PC, *Compliance Guide for 501(c)(3) Public Charities* (2014) 15–17 <https://www.irs.gov/pub/irs-pdf/p4221pc.pdf>.
[84] *IRC* § 6033. There are other returns that charities may need to file with the IRS such as Unrelated Business Income Tax Returns, Employment Returns, and Donee Information Returns.
[85] See <https://www.irs.gov/pub/irs-pdf/f990.pdf>.
[86] See <https://www.irs.gov/pub/irs-pdf/f990sf.pdf>.
[87] See *Pension Protection Act of 2006* (US) § 1223.
[88] See IRS, *International Activities of Domestic Charitable Organizations* (Video Transcript, August 2011) 14 <http://www.irsvideos.gov/InternationalActivitiesDomesticCharitableOrgs/files/Transcript.pdf>.
[89] US Department of the Treasury, Anti-Terrorist Financing Guidelines: Voluntary Best Practices for US-Based Charities (2002, as amended) <http://www.treasury.gov/press-center/press-releases/Documents/0929%20finalrevised.pdf>.
[90] US Department of Treasury, Office of Foreign Assets Control, *Specially Designated Nationals List* <http://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx>.
[91] Mark Sidel, 'Choices and Approaches: Anti-Terrorism Law and Civil Society in the United States and the United Kingdom After September 11' (2011) 61(1) *University of Toronto Law Journal* 119, 122–5, 124.
[92] See Internal Revenue Service, 'Reliance Standards for Making Good Faith Determinations' (77 FR 58796 (24 September 2012) <https://www.federalregister.gov/articles/2012/09/24/2012-23553/reliance-standards-for-making-good-faith-determinations>. The most significant change was expanding the class of qualified tax practitioners who may assist private foundations to make equivalency determinations for grants to foreign charities. See also US Department of State, 'Hillary Rodham Clinton's Remarks at the Launch of the Department of State's Global Philanthropy Working Group' (24 September 2012) <http://iipdigital.usembassy.gov/st/english/texttrans/2012/09/20120924136490.html#axzz3RI5EJQR>.

information about nonprofit organisations around the world, allowing multiple grantmakers to rely on its equivalency determinations.[93]

The IRS also conducts compliance checks and audits. A compliance check reviews whether an organisation is adhering to record keeping and information reporting requirements and/or whether an organisation's activities are consistent with its stated tax-exempt purpose.[94] There is no penalty for refusing to participate in a compliance check, although the IRS has the option of auditing an organisation whether or not it has participated in a compliance check, where the IRS can revoke charitable status and impose penalties for non-compliance. Research has shown that despite the enormous growth of the nonprofit sector over the two decades up to 2005, the number of IRS agents working in the tax exempt sector had not increased and the amount of tax exempt organisations being audited by the IRS was less than one per cent.[95]

USAID: Registration Requirements and Contractual Requirements in Grant Agreements

The United States Agency for International Development (USAID) provides funding to US-based and international NGOs, or 'Private Voluntary Organizations' (PVOs) to address global humanitarian and development needs. To be eligible for funding, most PVOs must apply to be registered with the PVO Registry.[96] There are eight detailed registration conditions specifying definitional and operational standards, including legal status, governance standards and financial conditions. US organisations must also establish that they are organised and have their headquarters in the US,[97] while foreign organisations must establish that they are organised and have their headquarters in the country in which they are domiciled.[98] Once registered, PVOs are eligible to compete for grants, cooperative agreements and other types of funding. Successful applicants will then be subject to the contractual requirements outlined in the grant agreements.[99]

B. Self-regulation

InterAction: PVO Standards

InterAction is an alliance of US-based NGOs that work in developing countries, with more than 180 members. InterAction has developed a set of Private Voluntary Organisation (PVO) Standards that provide an operational and ethical code of conduct for its members, covering governance, financial reporting, fundraising, public relations, management practice, human resources and program services.[100] The PVO Standards are managed and enforced by the Membership and Standards Committee of the InterAction Board of Directors. Noncompliance with the standards can result in suspension of a member or denial of a membership application. Members are required to participate in a mandatory compliance process every two years, known as Self-Certification Plus, in which they undertake a self-assessment and validation of compliance with the Standards.

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[93] See NGOsource <http://www.ngosource.org/>. The International Center for Not-for-Profit Law has also prepared country reports with information on local laws that should be considered when undertaking an equivalency determination. See Council on Foundations, *Country Notes* <http://www.cof.org/global-grantmaking/country-notes>.
[94] IRS Publication 4386, *Compliance Checks* < https://www.irs.gov/pub/irs-pdf/p4386.pdf>.
[95] See Leslie Oakes, 'Terrorists and Tax Cheats: Transforming Accountability in US Nonprofits' in Zahirul Hoque and Lee Parker (eds), *Performance Management in Nonprofit Organizations: Global Perspectives* (Routledge, 2015) 43, 54.
[96] Certain types of NGOs do not need to register as a PVO, including universities, local indigenous NGOs, private foundations, hospitals, exclusively religious institutions, and organisations applying for awards from the Office of U.S. Foreign Disaster Assistance. See <https://www.usaid.gov/pvo>.
[97] See USAID, *Conditions of Registration for U.S. Organizations* <https://www.usaid.gov/sites/default/files/documents/1880/PVO_Conditions_US.pdf>.
[98] See USAID, *Conditions of Registration for International Organizations (Non-U.S. Organizations)* <https://www.usaid.gov/sites/default/files/documents/1880/PVO_Conditions_International.pdf>.
[99] See <https://www.usaid.gov/work-usaid/get-grant-or-contract/grant-and-contract-process#policy>.
[100] See <https://www.interaction.org/document/interaction-pvo-standards>.

1.2.3 Jurisprudence

The 'in US requirement' has been the subject of a number of cases examining whether contributions to foreign charities are deductible under the *IRC*. In the 1980 case of *Bilingual Montessori School of Paris v Commissioner of Internal Revenue*[101] the Tax Court held that charitable contributions to a qualified organisation were tax deductible even if the US charity conducts all of its activities in a foreign country. In that case, a US taxpayer who donated to the Bilingual Montessori School, which was located and operated solely in Paris, was eligible for a deduction because the school was organised and incorporated under Delaware law and the donations were made directly to the US entity. In *Winn v Commissioner of Internal Revenue*[102] the Court of Appeals for the Fifth Circuit, reversing in part the decision of the Tax Court, held that the petitioners made a deductible charitable contribution of funds for the use of a Presbyterian Church, which was created in the US, where an officer of the church received the donation at an event it sponsored and subsequently those funds were used to support missionary work in Korea.

There have also been some more recent cases where US taxpayers made donations to churches abroad having US counterparts in which the Tax Court determined that these donations were not tax deductible because the direct recipients of the funds were not qualified organisations under the *IRC*. In *Anonymous v Commissioner of Internal Revenue*[103] the petitioners, a couple, argued that they were entitled to a deduction for donations to the Catholic Church in the wife's native country, as the Catholic Church is a universal organisation, and therefore Catholic churches in the wife's native country are qualified organisations. The Tax Court held that it had no basis to find that the Catholic churches in that foreign country were created or organized in the US or under the laws of the US. Similarly, in *Pauline T Golit v Commissioner of Internal Revenue*[104] the petitioner argued that she was entitled to a deduction for donations to a catholic church in Nigeria, but the Tax Court held that the church was not a domestic qualified organisation and therefore contributions made to the church were not deductible.

1.2.4 Summary of Legal and Regulatory Framework

The complex legislative architecture in the US adopted for the regulation of cross-border charity has resulted in the adoption of administrative workarounds to facilitate the foreign activities of charities. US charities can engage in charitable endeavours overseas. Foreign organisations can qualify as a US charity and receive income tax exemption, but under the tax code are not permitted to receive tax deductible contributions. The IRS has mitigated the consequences of this 'in United States' residency requirement for deductibility by permitting a US charity to use tax deductible funds to make gifts to foreign charities in furtherance of its charitable purposes and to serve as a giving intermediary, provided that it exercises proper 'control and discretion' over the funds. This 'red light' control requirement does not impose significant administrative burdens for public charities, although private foundations are subject to increased compliance costs through the requirement to undertake expenditure responsibility or equivalency determinations when sending funds abroad.

FATF has commended the range of anti-terrorism measures applying to charities operating overseas, such as the US Treasury's *Anti-Terrorist Financing Guidelines*, as well as the IRS's registration and Form 990 reporting requirements that seek detailed information on all cross-border activities and donations. At the same time, FATF cautioned that the ability of the IRS to conduct ongoing monitoring through investigations and audits is comprised by a lack of resources.

[101] *Bilingual Montessori School of Paris Inc v Commissioner of Internal Revenue* 57 TC 480 (1980).
[102] *Winn v Commissioner of Internal Revenue*, 595 F.2d 1060 (5th Cir. 1979).
[103] *Anonymous v Commissioner of Internal Revenue* TC Memo 2010-87 (2010).
[104] *Pauline T Golit v Commissioner of Internal Revenue* TC Memo 2013-191 (2013).

International aid and development charities are subject to USAID's stringent screening process in order to be eligible for government grants, followed by ongoing monitoring and reporting requirements through contractual obligations. Self-regulation by these charities through InterAction's rigorous compliance measures provides an additional 'green light' mechanism that promotes the efficient use of charitable resources and facilitates legitimate cross-border flows.

1.3 United Kingdom

In the UK[105] two governmental agencies are responsible for the regulation of charities. The Charity Commission for England and Wales (Charity Commission) is the primary charity regulator, while HM Revenue and Customs (HMRC) assesses charities for tax relief. Through its funding arrangements, the Department for International Development (DFID) is indirectly involved in the regulation of certain UK charities working overseas in international development. Some organisations engaged in development and relief work overseas also undertake self-regulation through Bond.

The most recent evaluation by the Financial Action Task Force (FATF) in 2007 found the UK to be 'largely compliant' with Recommendation 8. The Charity Commission's role was central to this finding. The report commended the Charity Commission's registration and reporting requirements, as well as its extensive guidance on legal and regulatory compliance for charities operating internationally. [106] In response to the FATF evaluation, the Charity Commission adopted a strategic plan for 2015-18 and is now focused on being a 'risk-based regulator', with an emphasis on enforcement and prevention.[107]

This section examines the legislative and regulatory measures employed to regulate charities engaged in charitable endeavours outside the UK.

1.3.1 Legislative Measures

Anti-terrorism Legislation

In the UK, new anti-terrorism legislation has been enacted following the September 11 terrorist attacks, notably the *Terrorism Act 2006* (UK), *The Terrorist Asset-Freezing etc. Act 2010* (UK) and the *Terrorism Prevention and Investigation Measures Act 2011* (UK). The existing anti-terrorism statute, the *Terrorism Act 2000* (UK), was also strengthened to include general offences relating to the provision of funds or other property to individuals who use them for the purposes of terrorism.

Tax Legislation: Jurisdiction, Registration and Management Requirement and Reasonableness Determination for Charitable Tax Relief

The English common law definition of charity was codified in the *Charities Act 2006* (UK),[108] now contained in the *Charities Act 2011* (UK).[109] The enactment of the *Finance Act 2010* (UK) introduced a new definition of charity for tax purposes[110] (linked to the definition in the *Charities*

[105] While most tax laws apply across the UK, each jurisdiction has its own charity laws and charity regulator (the Charity Commission for England and Wales, the Charity Commission for Northern Ireland and the Office of the Scottish Charity Regulator). References to the UK in this report are limited to the charity law of England and Wales.
[106] FATF, *Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism – The United Kingdom of Great Britain and Northern Island* (2007).
[107] Charity Commission, *Strategic Plan 2015-18* (June 2015) 1 <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/567527/Strategic_plan_2015-18.pdf>.
[108] *Charities Act 2006* (UK) c 50.
[109] *Charities Act 2011* (UK) c 25 s 1.
[110] *Finance Act 2010* (UK) c 13 s 30 sch 6.

Act), which applies to all charities seeing charitable tax relief. Pursuant to the *Finance Act*, for tax purposes a charity is defined as a body of persons or trust that:[111]

- is established for charitable purposes[112] only as defined in the *Charities Act 2011* (UK),[113] and those purposes must be for the public benefit;[114]
- meets the jurisdiction condition (i.e. is subject to the control of a relevant UK or EU court or the equivalent under the law of another territory);
- meets the registration condition (by complying with any requirement to be registered as a charity in the UK or with any equivalent requirement under the law of another territory); and
- meets the management condition requiring that its managers are 'fit and proper persons'.[115]

The result of this definition is that in order to access charitable tax relief in the UK (including accessing tax relief for donations through the Gift Aid Scheme) a charity must be based in the UK, EU, Norway, Iceland or Liechtenstein, established for charitable purposes only, be registered with the Charity Commission (or an equivalent country regulator), and be managed by 'fit and proper persons', providing the HMRC with significant oversight over trustees and senior managers.

Prior to the *Finance Act,* charities could send funds abroad provided they took reasonable steps to ensure that the funds would be applied for charitable purposes under English law. The *Finance Act* added the provision that charities must take 'such steps as the Commissioner of Her Majesty's Revenue and Customs consider are reasonable' when transferring funds abroad to ensure that funds are applied for the organisation's charitable purposes. [116] Following an assessment by HMRC (outlined below), any funds found by HMRC not to have been applied for charitable purposes under English law may be deemed non-charitable expenditure, resulting in loss of the charity's tax relief.[117]

1.3.2 Regulatory Measures

A. Government Regulation

Charity Commission: Registration, Recordkeeping, Guidance, Reporting Requirements and Investigations

The Charity Commission's statutory objectives, functions, powers and duties are set out in the *Charities Act 2011*. The Charity Commission's stated aims include assuring the public that money intended for charitable purposes is used by charities in accordance with the law and that charitable organisations act wholly in pursuit of those purposes in order to protect public trust and confidence in charity.[118] To carry out this aim, the Commission has adopted a risk-based

[111] *Finance Act 2010* (UK) c 13 s 30 sch 6.
[112] See *Charities Act 2011* (UK) c 25 s 3(1) for a list of charitable purposes.
[113] See *Charities Act 2011* (UK) c 25 s 1.
[114] See *Charities Act 2011* (UK) c 25 s 2.
[115] See HMRC, *Guidance on the fit and proper persons test* (May 2016) <www.gov.uk/government/publications/charities-fit-and-proper-persons-test/guidance-on-the-fit-and-proper-persons-test>. The 'fit and proper' test was designed to prevent abuse of an organisation's charitable tax status by its trustees and senior managers.
[116] *Finance Act 2010* (UK) c 13 sch 8 s 2(1). See also *Corporation Tax Act 2010* (UK) s 500 and *Income Tax Act 2007* (UK) s 547.
[117] HMRC, *Charities: Detailed Guidance Notes, Annex II: Non-Charitable Expenditure* (April 2016) <https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-ii-non-charitable-expenditure>.
[118] See Charity Commission statement of mission, regulatory approach and values (July 2014) <https://www.gov.uk/government/publications/charity-commission-statement-of-mission-regulatory-approach-and-values/charity-commission-statement-of-mission-regulatory-approach-and-values#fn:1>.

approach to regulation.[119] Its starting point is that charities are publicly accountable for the funds they receive and privileges they enjoy because of their charitable status, and the responsibility for their administration and management rests with the trustees.

The Charity Commission regulates the international activities of charities under its general powers, treating the issue as essentially part of the fiduciary duties of trustees to apply charitable funds in furtherance of the charity's purposes and to observe the duty of care and in doing so exercise proper risk management. In doing so, it has explicitly recognised the challenges faced by charities operating in particular parts the world.[120]

Organisations are legally obliged to apply to register as a charity if they have an income of at least £5,000 and have been set up for exclusively charitable purposes; have purposes that are for public benefit; and fall within the jurisdiction of the High Court of England and Wales.[121] The Charity Commission makes a formal assessment of all applications for registration on a case-by-case basis using its risk framework, and if it is satisfied that the criteria are met, then it adds the charity to the register. As part of the registration process, the Charity Commission requires information on the charity's proposed activities, proof of income, governing documents and checks that individuals named as trustees are eligible to act in that capacity. It also obtains intelligence from HMRC before registering an organisation based on an information-sharing agreement between the two agencies.[122]

All charities must keep accounting records for a minimum of six years and make these available to the public on request.[123] All registered charities with income greater than £10 000 are required to submit an annual return to the Charity Commission, which includes information on the amount spent in each country overseas.[124] Those with an income over £25 000 must also submit a trustees' annual report and annual accounts.

The Charity Commission seeks to enable charities to comply with their legal requirements by the provision of appropriate guidance. To this end, it has produced substantial guidance on issues involving charities carrying out international activities, including information on how to manage risks when working internationally,[125] and a detailed Compliance Toolkit, with chapters on charities and terrorism, due diligence and monitoring of funds sent overseas.[126]

The Commission has a range of statutory powers that it can use to stop abuse and protect charitable assets and beneficiaries. These include information gathering powers, temporary protective powers of intervention to protect charitable property, and remedial powers to resolve

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[119] See Charity Commission, *Risk Framework* (February 2016) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/568897/Risk_framework_2016.pdf>. 'The essence of risk-based regulation…is the prioritizing of regulatory actions in accordance with an assessment of the risks that parties will present to the regulatory body's achieving its objectives'. See Robert Baldwin, Martin Cave and Martin Lodge, *Understanding Regulation: Theory, Strategy, and Practice* (Oxford, 2012) 281.

[120] Charity Commission, *Counter-terrorism Strategy* (September 2015) 8 <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/465994/counter-terrorism_strategy.pdf>.

[121] Certain organisations are exempt from registration because they are excepted such as churches, scout/guide groups or armed forces organisations and have income less than £100 000, or exempt such as academy trusts (type of government funded schools), some named museums and community benefit societies. See *Charities Act 2011* (UK) c 25 ss 30–33. See also Charity Commission of England and Wales, *Guidance: Excepted Charities* (11 June 2014) <https://www.gov.uk/government/publications/excepted-charities/excepted-charities--2>.

[122] National Audit Office, 'The Regulatory Effectiveness of the Charity Commission' (Report, HC 813, Session 2013-14, 4 December 2013) [2.15] <http://www.nao.org.uk/wpcontent/uploads/2013/11/10297-001-Charity-Commission-Book.pdf>.

[123] *Charities Act 2011* (UK) c 25 s 131. See also Charity Commission, *Charity Reporting and Accounting: The Essentials* (January 2013) <https://www.gov.uk/government/publications/charity-reporting-and-accounting-the-essentials-cc15b/charity-reporting-and-accounting-the-essentials>.

[124] *Charities Act 2011* (UK) c 25 s 15. See also Charity Commission of England and Wales, *Send a Charity's Annual Return* <https://www.gov.uk/send-charity-annual-return>.

[125] Charity Commission of England and Wales, Charities: *How to Manage Risks When Working Internationally* (May 2013) <https://www.gov.uk/charities-how-to-manage-risks-when-working-internationally>.

[126] Charity Commission of England and Wales, *Compliance Toolkit: Protecting Charities from Harm* (September 2013) <https://www.gov.uk/government/collections/protecting-charities-from-harm-compliance-toolkit>.

longer term issues of concern.[127] In certain circumstances, it can open a statutory inquiry into the charity when it has concerns about how a charity is being run, which enables it to exercise an array of enforcement powers.[128] In the past, almost all of the Commission's investigations cases were opened because of issues raised by trustees, other public bodies, complainants, or the public. The Commission now takes a more proactive approach. It checks a sample of charity accounts each year, representing around two per cent of the charities by number on the register,[129] although few investigations were opened as a result of this work.[130] The Charity Commission also monitors charities in higher risk cases, and is required to take steps to identify charities that may be involved in terrorist financing pursuant to the *Terrorism Act 2000* (UK).[131]

This proactive approach was evidenced in a request by the Charity Commission that funders of CAGE, an advocacy organisation that works to empower communities affected by the war on terror, would not provide future support for the charity due to its alleged links with terrorists. In 2015, CAGE and one of its funders brought a judicial review of the Commission's request before the High Court arguing that it acted outside its powers. The parties settled, with both sides agreeing that the trustees must be free to exercise their fiduciary duties and discretion to provide future funding. The case highlighted the limits of the Commission's power to intervene in situations where there is an alleged misuse of charitable funds in aiding terrorism, particularly where this exercise of power may be seen as the result of political pressure.[132]

A review of the regulatory effectiveness of the Charity Commission by the National Audit Office found that the Charity Commission was 'not do[ing] enough to identify and tackle the abuse of charitable status',[133] and recommended that the Cabinet Office 'assist the Commission in securing legislative changes to address gaps and deficiencies in the Commission's powers'.[134] In response, the Government released a draft Protection of Charities Bill in October 2014 and provided the Charity Commission with an additional £8 million in funding, to strengthen the Commission's investigatory and enforcement powers to prevent the abuse of charities for terrorist and other criminal purposes.[135] The Bill was introduced in Parliament in May 2015 and the *Charities (Protection and Social Investment) Act* was passed in 2016. The Act gives the Charity Commission a new power to issue (and publicise) an 'official warning' to charities or charity trustees concerning relatively minor misconduct, with an official statutory inquiry being undertaken for more serious issues. These investigatory powers have been extended under the Act and include the power to remove trustees following an inquiry and to direct the winding up of a charity. The

[127] See Charities Commission, *Risk Framework* (February 2016) 8 <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/568897/Risk_framework_2016.pdf>.
[128] *Charities Act 2011* s 46.
[129] National Audit Office, 'The Regulatory Effectiveness of the Charity Commission' (Report, HC 813, Session 2013-14, 4 December 2013) [1.28] <http://www.nao.org.uk/wpcontent/uploads/2013/11/10297-001-Charity-Commission-Book.pdf>.
[130] National Audit Office, 'The Regulatory Effectiveness of the Charity Commission' (Report, HC 813, Session 2013-14, 4 December 2013) [1.29] <http://www.nao.org.uk/wpcontent/uploads/2013/11/10297-001-Charity-Commission-Book.pdf>
[131] *Terrorism Act 2000* (UK) c 11 s 12. Charity Commission, *Counter-terrorism Strategy* (September 2015) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/465994/counter-terrorism_strategy.pdf><https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/313532/ctstext.pdf>.
[132] See Debra Morris, 'The Charity Commission of England and Wales: A Fine Example or Another Fine Mess?' (2015) 91(3) *Chicago-Kent Law Review* 965, 973-5.
[133] National Audit Office, 'The Regulatory Effectiveness of the Charity Commission' (Report, HC 813, Session 2013-14, 4 December 2013) 9 <http://www.nao.org.uk/wpcontent/uploads/2013/11/10297-001-Charity-Commission-Book.pdf>. At the same time, the Cabinet Office published *Consultation on Extending the Charity Commission's Powers to Tackle Abuse in Charities* (December 2013) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/263248/Consultation-on-Extending-the-Charity-Commissions-powers_4-December.pdf>.
[134] National Audit Office, 'The Regulatory Effectiveness of the Charity Commission' (Report, HC 813, Session 2013-14, 4 December 2013) 11 <http://www.nao.org.uk/wpcontent/uploads/2013/11/10297-001-Charity-Commission-Book.pdf>.
[135] Minister for the Cabinet Office (UK), *Draft Protection of Charities Bill* (October 2014) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/365710/43820_Cm_8954_web_accessible_Draft_protection_of_charities_bill.pdf>. See also Prime Minister David Cameron, 'New Funding and Powers to Tackle Abuse in the Charity Sector' (Press Release, 22 October 2014) <https://www.gov.uk/government/news/new-funding-and-powers-to-tackle-abuse-in-the-charity-sector>.

Act also extends the scope of convictions, which will result in a person being disqualified from acting as a charity trustee to include offences under counter-terrorism and money laundering legislation and gives the Charity Commission wide discretionary powers to disqualify people from acting as charity trustees.

HMRC: Registration, Reasonableness Determination, and Audits

The *Finance Act 2010* (UK) ('*Finance Act*') gave HMRC a greater role in the regulation of charities. Charities are now required to show HMRC that they satisfy the jurisdiction, registration and management conditions in the *Finance Act*. For the latter, HMRC suggests that the charity require managers and trustees sign a declaration that they are 'fit and proper persons' for the charity to maintain for its records and provide to HMRC if requested.[136] Charities must also undergo a registration process with HMRC (in addition to registering with the Charity Commission) in order to qualify for charitable tax relief, providing charitable objectives, governing documents and officials' details.[137]

In order for a charity in an EU Member State, Norway or Iceland to be able to access charitable tax relief in the UK, the charity must pass a 'comparability test' in which it must prove to HMRC that it meets the legal requirements for a charity set forth in the *Finance Act*.[138] In doing so, the organisation may be required to provide documents evidencing its charitable status. If the organisation succeeds, it will be included in a list of qualifying charities kept by HMRC. In practice, obtaining recognition as a charity with HMRC for charities outside the UK has been 'slow and lengthy', with 142 of these foreign charities having applied for recognition by early 2015, of which only 11 had been successful, and with fewer than five having made Gift Aid claims.[139]

Funds sent overseas by a UK charity will only be considered a charitable expenditure for UK tax purposes if two conditions are met. In essence, these conditions require that the charity provides detailed information and documentation demonstrating that it has exercised control over the funds. The first condition (which applies to all charitable payments) is that the payment must be for charitable purposes. The second (an additional condition for payments overseas) is that the UK charity must clearly demonstrate to the Commissioners for HMRC that it has taken 'reasonable steps in the circumstances' to ensure that the payment is applied for charitable purposes.[140] This second condition is provided for in the *Income Tax Act 2007*[141] and the *Corporation Tax Act 2010*[142] for charitable trusts and companies, respectively. In order to satisfy this condition, when reviewing payments made to overseas bodies HMRC will generally ask the trustees to provide them with information and supporting documentation specifying:

- the person to whom and the specific charitable purpose for which the payment was given, the reasons for payment, and how the decision to provide the payment was arrived at, including the due diligence undertaken;
- a written agreement demonstrating the guarantees or assurances that have been obtained from the foreign charity that the payment will be applied for the purpose for

[136] See HMRC, *Fit and proper persons help sheet and declaration* <www.gov.uk/government/uploads/system/uploads/attachment_data/file/392977/model-dec-ff-persons.pdf>.
[137] See <https://www.gov.uk/charity-recognition-hmrc>. Prior to 2010, only excepted and exempt charities went through a full registration process with HMRC. In other cases HMRC accepted registration with the Charity Commission for tax purposes.
[138] See European Foundation Centre and Transnational Giving Europe, 'United Kingdom: Country Profile' (2014) 2.
[139] Bill Lewis and Lucinda Ellen, 'Opening the Door to Overseas Charities' in *Charity and Social Enterprise Update* (Bates Wells Braithwaite, 2015) 21.
[140] See HMRC, *Guidance: Annex ii - Non-Charitable Expenditure* (April 2016) <www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-ii-non-charitable-expenditure>.
[141] *Income Tax Act 2007* (UK) s 547.
[142] *Corporation Tax Act 2010* (UK) s 500.

which it was given and the financial controls in place, including provision of financial records;

- steps the trustees took to ensure the charitable application of funds (such as safeguards, monitoring and oversight); and
- follow-up action taken by the trustees to confirm that payments were applied properly.

Trustees must also identify any specific risks for projects where they exist in particular countries. When assessing whether the steps taken by the charity were 'reasonable in the circumstances', HMRC will consider: the charity's knowledge of and history with the foreign charity; the amounts given; and the adequacy of the charity's internal financial, management and decision making procedures, and the extent to which the charity adheres to these procedures.[143]

HMRC audits charities to ensure that the Gift Aid Scheme is being used properly and that any repayment claims made are accurate. In the course of these audits HMRC may look at other tax issues including whether there is any non-charitable expenditure. Charities are generally selected for review on a 'risk' basis, with a number also selected randomly.[144]

DFID: Contractual Requirements in Grant Agreements

The Department for International Development (DFID) provides funding to UK and international NGOs. To be eligible for funding, DFID makes an assessment of the adequacy of the organisations' governance arrangements prior to engaging with them.[145] Funding is provided through agreements, such as Programme Partnership Arrangements and Strategic Grant Agreements. These agreements contain provisions for monitoring and compliance, including reporting requirements undertaken though a reporting and performance assessment framework.[146]

B. Self-regulation

Bond: Charter for International Development Organisations

Bond is the peak body for UK international development organisations, with over 450 members. Bond does not consider itself to be a regulatory body and does not monitor or regulate the actions of its members.[147] However its members commit to a charter of uniting principles, which draws on a range of existing codes, governance and professional standards, including the international Global Standard for CSO Accountability, Sphere Humanitarian Charter and Minimum Standards in Humanitarian Response, and the CHS Alliance Core Humanitarian Standard, as well as the England and Wales based Code of Good Governance and the Institute of Fundraising's Code of Fundraising Practice (which was recently taken over by the new Fundraising Regulator).[148]

1.3.3 Jurisprudence

Since the mid-2000s, EU case law as interpreted by the European Court of Justice (ECJ) has had some impact on charitable tax relief available to UK Charities. In two key judgments dealing with the tax treatment of charities, the ECJ has developed a general non-discrimination principle

[143] See HMRC, *Guidance: Annex ii - Non-Charitable Expenditure* (April 2016) <www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-ii-non-charitable-expenditure>.
[144] See HMRC, *Guidance: Audits by HMRC Charities* (April 2016) <www.gov.uk/government/publications/charities-detailed-guidance-notes/chapter-7-audits-by-hmrc-charities>.
[145] National Audit Office, *Department for International Development: Working with Non-Governmental and other Civil Society Organisations to Promote Development* (July 2006) 5 <https://www.nao.org.uk/wp-content/uploads/2006/07/05061311.pdf>.
[146] See <http://www.international.gc.ca/development-developpement/partners-partenaires/bt-oa/contribution_general-accord_general.aspx?lang=eng>.
[147] See <https://www.bond.org.uk/charter#important_note>.
[148] See <https://www.bond.org.uk/charter>.

according to which a foreign charity in the EU is entitled to hold the same tax privileged status as a domestic charity, provided that it can be shown to be comparable to a domestic charity.[149]

In the 2006 case of *Centro di Musicologia Walter Stauffer v Finanzamt München für Körperschaften* ('*Stauffer*'),[150] an Italian foundation supporting music education owned a building in Germany from which it received rental income. For a German charitable foundation, rental income was exempt from corporation tax, but the German tax authorities would not grant exemption to the Stauffer Foundation because it was based in Italy. The ECJ held that such rental income is protected under the free movement of capital. Restrictions on the fundamental freedoms are only permissible if they are applied in a non-discriminatory way and are justified by overriding reasons in the public interest. The less favourable treatment of foreign EU charities is not justifiable according to these criteria. Therefore, non-resident charities should not be treated differently for tax purposes simply because they are resident in another Member State. As a result, if a Member State allows a tax exemption for domestic charities, it should extend such tax benefits to charities in other Member States provided they meet the same conditions as domestic charities.

This was followed by the 2009 case *Hein Persche v Finanzamt Lüdenscheid* ('*Persche*'),[151] brought by Mr Persche, a German citizen, who made an in-kind gift to a retirement home with a children's home attached in Portugal, which was a registered charity under Portuguese law. Mr Persche claimed a tax deduction for the gift in his German income tax return, which was refused by the German tax office on the basis that the recipient charity was not established in Germany, a requirement under German law. The ECJ ruled in favor of Mr Persche, determining that restricting tax deductibility to donations to domestic charities to the exclusion of charities in other Member States that satisfy the requirements for charitable status in the donor's Member State is not compatible with the free movement of capital. The non-discrimination principle established in *Stauffer* and *Persche* was reaffirmed in later cases.[152]

These cases had an immediate impact on the UK. Following the *Stauffer* decision the European Commission sent the UK a formal request in the form of a reasoned opinion to end its discrimination against charities in other Member States.[153] The Commission identified obstacles to the free movement of capital, the free movement of persons, and the freedom of establishment — all brought about by the fact that the favourable tax treatment of donations was only granted if the charity was established in the UK.[154] The UK responded by including provisions in the *Finance Act*, to reflect this principle of non-discrimination and (in theory) expanded charitable tax relief beyond its geographic borders.

1.3.4 Summary of Legal and Regulatory Framework

In response to a series of ECJ cases establishing a principle of non-discrimination for European cross-border charity, the *Finance Act* introduced a new definition of charity for tax purposes that was in theory expansive enough to recognise foreign (European) charitable organisations as UK charities eligible for UK tax relief. At the same time, this geographic expansion was underpinned by expanding the supervisory role of HMRC by introducing new 'red light' measures in the form of

[149] Thomas von Hippel, 'Taxation of Cross-Border Philanthropy in Europe After Persche and Stauffer: From Landlock to Free Movement?' (European Foundation Center, 2014), 12–20.
[150] *Centro di Musicologia Walter Stauffer v Finanzamt München für Körperschaften* (C-386/04) [2006] ECR I-8234.
[151] *Hein Persche v Finanzamt Lüdenscheid* (C-318/07) [2009] I-359.
[152] See eg, *Missionswerk Werner Heukelbach eV v Belgium* (C-25/10) [2011] ECR I-497 and *European Commission v Austria* (C-10/10) [2011] ECR I-5389.
[153] See 'Commission Requests the United Kingdom to End Discrimination of Foreign Charities' (Press Release, IP/06/964, 10 July 2006).
[154] Sabine Heidenbauer, *Charity Crossing Borders: The Fundamental Freedoms' Impact on Charity and Donor Taxation in Europe* (Kluwer Law International, 2011) 91.

specific legislative provisions to regulate the foreign activities of charities. The most significant of these is the imposition of control requirements under the *Finance Act*.

The Charity Commission has historically focused on 'green light' regulation by issuing extensive guidance and advice to charities operating overseas, with some disclosure on overseas funding in its annual information statements. While the most recent FATF evaluation commended the work of the Charity Commission, the Government has introduced new legislation to strengthen the Commission's investigatory powers to prevent the misuse of charities for terrorist financing purposes. As a result, the Commission has shifted towards a risk-based approach in addressing the specific objectives of mitigating the risk of charities operating overseas being misused for terrorism.

International development charities that have funding agreements with DFID are also subject to additional ongoing monitoring and reporting requirements through their contractual obligations, however there is no up-front accreditation or registration process. Self-regulation has not been employed as a primary means of regulating the sub-sector of charities operating overseas, as Bond does not monitor the actions of its members.

1.4 Australia

In Australia, two federal governmental agencies are primarily responsible for the regulation of charities:[155] the Australian Charities and Nonprofits Commission (ACNC), recently established in 2012 as Australia's first national charity regulator; and the Australian Taxation Office (ATO), responsible for administering and enforcing tax law for not-for-profit organisations (NFPs). Once a charity is registered with the ACNC, it can be endorsed by the ATO to access NFP tax concessions, including income tax exemption and deductible gift recipient (DGR) status.[156] The Department of Foreign Affairs and Trade (DFAT) and to a lesser extent, the Department of the Environment (DOE), are also involved in the regulation of certain Australian charities working outside Australia. In addition to governmental regulation, Australian international development and relief organisations engage in self-regulation through their peak body, the Australian Council for International Development (ACFID).

The most recent evaluation by the Financial Action Task Force (FATF) in 2015 rated Australia non-compliant with Recommendation 8, finding that 'Australia has not implemented a targeted approach nor has it exercised oversight in dealing with non-profit organisations (NPOs) that are at risk from the threat of terrorist abuse'.[157] Overall, FATF found the supervisory framework including the registration and reporting requirements for NPOs and the domestic coordination and information sharing to be wanting, leaving 'Australian NPOs vulnerable to misuse by terrorist organisations'.[158] FATF was particularly critical of the ACNC for not collecting information from, conducting outreach to, or adequately monitoring the charitable sector in relation terrorist financing. In response, the ACNC is undertaking a national risk assessment into the not-for-profit sector.

This section examines the legislative framework and regulatory measures employed to regulate Australian charities engaged in charitable endeavours overseas.

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[155] In addition to federal regulation, most charities are incorporated associations and are regulated by state and territory governments, with obligations such as providing annual reports and keeping financial records. Charities that undertake fundraising activities may also be required to meet obligations to a fundraising regulator in the state or territory in which they operate.

[156] Unlike the other jurisdictions where charities are generally eligible to receive tax deductible donations, in Australia a tax deduction is only available for gifts to organisations that qualify as DGRs.

[157] FATF, Anti-money Laundering and Counter-terrorist Financing Measures - Australia, Fourth Round Mutual Evaluation Report (FATF/APG, 2015) 6.

[158] FATF, Anti-money Laundering and Counter-terrorist Financing Measures - Australia, Fourth Round Mutual Evaluation Report (FATF/APG, 2015) 16.

1.4.1 Legislative Measures

Anti-terrorism Legislation

Since the September 11 terrorist attacks, Australia has introduced a wide range of anti-terrorism legislation, including the *Proceeds of Crime Act 2002* (Cth) and the *Suppression of the Financing of Terrorism Act 2002* (Cth), and the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth). It has also strengthened existing legislation, including the *Criminal Code Act 1995* (Cth) which creates a number of offences including getting funds to or from a terrorist organisation, providing support to a terrorist organisation, and associating with a terrorist organisation. For this last offence, the *Criminal Code* has a humanitarian aid exception.

Tax Legislation: 'In Australia' Residency and Operational Requirements for Income Tax Exemption and Tax Deductible Status

Charities are defined in the *Charities Act 2013* (Cth) as nonprofit organisations with charitable purposes that are for the public benefit.[159] All charities and other organisations[160] that have been endorsed by the ATO for income tax exemption or DGR status, are subject to the 'in Australia' residency and operational requirements contained in the *Income Tax Assessment Act 1997* (Cth) *('ITAA 1997*').

The 'in Australia' residency and operational requirement for income tax exemption states that an organisation has 'a physical presence in Australia and, to that extent, incurs its expenditure and pursues its objectives principally in Australia'.[161] The ATO has clarified that the definition of 'physical presence' is based on its ordinary meaning and that operating through a division in Australia is sufficient.[162] To the extent that a registered charity has a physical presence in Australia, it must pursue its objectives and incur its expenditure 'principally' in Australia. The ATO has stated that 'principally' means 'mainly or chiefly' and should be more than 50% although any distribution of gifts or government grants received is disregarded.[163] Further, expenditure is 'incurred' in Australia when a liability incurred in Australia is discharged or where money is paid in Australia.[164] The practical consequence of this 'in Australia' residency and operational requirement is that charities with income tax exemption can only operate and have beneficiaries outside Australia to the extent that these overseas activities represent no more than 50% of the organisation's total expenditure, excluding offshore distributions of gifts and government grants.

The 'in Australia' residency and operational requirement for DGR status states that 'the fund, authority or institution must be in Australia'.[165] The ATO has traditionally adopted a strict interpretation of this 'in Australia' condition, requiring that a DGR 'be established, controlled, maintained and operated in Australia' and have 'its benevolent purposes' in Australia.[166] The practical consequence is that donations made directly by Australian taxpayers to an organisation outside Australia are never tax deductible. Donations made to an Australian DGR that uses the gift for its own programs outside Australia are also not tax deductible unless its activities outside Australia are 'merely incidental to providing relief in Australia'[167] or the organisation obtained its

[159] *Charities Act 2013* (Cth) s 5.
[160] These include government institutions; community organisations with purposes that are primarily sporting, recreational or social in nature; and professional or occupational associations. Many of these organisations have not been endorsed by the ATO.
[161] *ITAA 1997* s 50-50(1)(a). Emphasis added. There are limited exceptions to this 'in Australia' provision for institutions specifically prescribed by the Income Tax Assessment Regulations to be tax exempt.
[162] ATO, *Income Tax: Endorsement of Income Tax Exempt Charities*, TR 2000/11, 28 June 2000 [12]–[13].
[163] ATO, *Income Tax: Endorsement of Income Tax Exempt Charities*, TR 2000/11, 28 June 2000 [15]–[17].
[164] ATO, *Income Tax: Endorsement of Income Tax Exempt Charities*, TR 2000/11, 28 June 2000 [15].
[165] *ITAA 1997* s 30-15. Emphasis added.
[166] ATO, *Income Tax and Fringe Benefits Tax: Public Benevolent Institutions*, TR 2003/5, 4 June 2003 ('TR 2003/5'), [129].
[167] TR 2003/5 [130].

DGR status pursuant to one of four limited exceptions: overseas aid funds;[168] developed country disaster relief funds;[169] public funds on the Register of Environmental Organisations;[170] and DGRs specifically listed by name in the *ITAA 1997* under the category of international affairs.[171] There is little legislative coherence to these exceptions, which Parliament added incrementally to the tax laws, influenced by interest groups.[172]

The law is not clear as to whether donations directed overseas that are channelled through an Australian organisation that has obtained its DGR status pursuant to an exception to the 'in Australia' residency and operational requirement are tax deductible, although the use of these qualified organisations as domestic giving intermediaries is a mechanism widely employed by Australian charities and their donors to circumvent the strict 'in Australia' requirements. These channelling arrangements, known as auspicing, typically involve contractual (and less formal) agreements, where a servicing fee is paid to the intermediary DGR 'in the range of 7–10% of the amount distributed'.[173]

More recently, the ATO's strict interpretation of 'in Australia' for DGRs appears to be shifting towards a more permissive approach, reverting to an interpretation it held prior to 1967 (when it abruptly changed policy course) that 'in Australia' requires only that an organisation be established and operated in Australia.[174] The ATO's recent reversal on the meaning of 'in Australia' in the tax legislation surfaced in 2012 when its taxation guide altered, stating that '[f]or funds, institutions and authorities to be in Australia, they must be established and operated in Australia'.[175] In early 2016 the ATO announced it would issue a new public ruling on the 'in Australia' residency and operational requirements, which is likely to reflect this more permissive approach.

1.4.2 Regulatory Measures

A. Government Regulation

ACNC: Registration, Governance Standards, External Conduct Standards, Guidance, Recordkeeping and Reporting Requirements

The ACNC is governed by the Australian *Charities and Not-for-profits Commission Act 2012* (Cth) ('*ACNC Act*'*)*. Registration of charities with the ACNC is voluntary, but is required for charities to access tax concessions from the ATO.[176] While it is possible for an organisation to apply for these tax concessions in the charity registration application to the ACNC, this is subject to a separate endorsement process undertaken by the ATO discussed below.

In order to register with the ACNC as a charity an organisation must meet the legal definition of charity pursuant to the *Charities Act 2013* (Cth), be in compliance with ACNC governance

[168] *ITAA 1997* s 30-85.
[169] *ITAA 1997* s 30-86. DGR status for these funds is limited to two years from the date specified in a Treasury Minister's declaration of the disaster. The ATO maintains a list of disasters that have been recognised by the Treasury since this provision was enacted in 2006. There are currently 10 disasters on this list. See Australian Taxation Office, *List of Disasters* (27 February 2015) <https://www.ato.gov.au/Non-profit/Gifts-and-fundraising/In-detail/Disasters/List-of-disasters/#Developedcountrydisasterrelieffund>.
[170] *ITAA 1997* s 30-55.
[171] *ITAA 1997* s 30-80. Parliament may amend the *ITAA 1997* specifically to list individual organisations by name as a DGR. There is currently 22 DGRs listed by name, although time limits for seven of these organisations had expired.
[172] See Natalie Silver, Myles McGregor-Lowndes and Julie-Anne Tarr, 'Should Tax Incentives for Charitable Giving Stop at Australia's Borders' (2016) 38 *Sydney Law Review* 8.
[173] Letter from Philanthropy Australia to Prime Minister Tony Abbott, 21 April 2015, 1 (on file with author).
[174] See N. Silver, M. McGregor-Lowndes and J. Tarr, 'Delineating the Fiscal Borders of Australia's Non-profit Tax Concessions' (2016) 14(3) *ejournal of Tax Research* 741, which discusses the ATO's different 'In Australia' interpretations over the years and their consequences.
[175] See ATO, 'GiftPack for Deductible Gift Recipients & Donors' (NAT 3132, 2015).
[176] *ACNC Act*, s 10-5.

standards, and have not been listed as an organisation engaging in or supporting terrorist or other criminal activities.[177] The registration process enables the ACNC to assess any governance or compliance risks and ensure that safeguards are in place. For organisations with overseas beneficiaries or activities, part of this assessment includes a determination of the level of risk associated with the jurisdiction and local partners in and with which the organisation operates and whether appropriate safeguards are in place to ensure that funds sends overseas will be applied to their charitable purposes.[178] The ACNC works in collaboration with the Australian Transaction Reports and Analysis Centre (AUSTRAC) to identify charities being misused for terrorist financing or other criminal purposes.[179]

Once registered, the ACNC has a number of tools for the ongoing regulation of the foreign activities of charities: governance standards, external conduct standards, recordkeeping and reporting requirements. The ACNC has developed a set of five governance standards that apply to all registered charities, other than basic religious charities.[180] These governance standards are a set of high level principles 'that require charities to remain charitable, operate lawfully, and be run in an accountable and responsible way.'[181] In ensuring compliance with these standards, the ACNC focuses on charities that have seriously or deliberately breached them through such means as diverting money to non-charitable purposes or being grossly negligent with their finances.[182] International aid and development charities that comply with the ACFID Code of Conduct (see below), meet the ACNC governance standards.[183] Failure to comply with the governance standards can result in a loss of entitlement to registration and may also lead to enforcement action by the ACNC Commissioner.[184]

The governance standards do not contain specific requirements for charities operating overseas. For these organisations, the *ACNC Act* provides for external conduct standards (ECSs) to regulate registered charities sending funds or engaging in activities outside of Australia.[185] Specifically, the ECSs aim to ensure that funds sent outside Australia by registered charities are reaching legitimate beneficiaries, being used for legitimate purposes and, along with these charities' overseas activities, are not contributing to terrorist or other criminal activities.[186] The *ACNC Act* contemplates that where there is a failure to comply with an ECS, the ACNC Commissioner may revoke the charity's registration or take enforcement action against the charity.[187] To date however, Parliament has not proclaimed the ECSs and as a result they have not been developed by the ACNC.[188]

Instead, the ACNC has issued guidance and a checklist to assist charities in minimising the risk of being used for raising and distributing funds for terrorist financing,[189] and a factsheet specifically

[177] *ACNC Act* s 25-5.
[178] See Australian Charities and Not-for-profits Commission, *Factsheet: Overseas Aid and Development Charities* <http://www.acnc.gov.au/ACNC/FTS/Overseas_charities.aspx>.
[179] This collaboration may also involve the Australian Federal Police, the Attorney-General's Department and state regulators.
[180] *ACNC Act* div 45. Charities are not basic religious charities if they are incorporated, endorsed to receive deductible gifts, or if they fall into other categories. The exemption for these small religious congregations is the result of a compromise to get the bill passed.
[181] *ACNC Act* s 50-5.
[182] See <www.acnc.gov.au/ACNC/Manage/Governance/ACNC/Edu/GovStds_overview.aspx?hkey=456b1d22-8869-4ad0-a0cd-48607244216e>.
[183] See <https://charity.acnc.gov.au/ACNC/FTS/Overseas_charities.aspx>.
[184] *ACNC Act* s 45-5, note 1.
[185] *ACNC Act* div 50.
[186] *ACNC Act* s 50-5 (1).
[187] *ACNC Act* s 50-5, note 1; s 35-10(1)(c)(ii).
[188] Australian Charities and Not-for-profits Commission, *External Conduct Standards* (2015) <https://www.acnc.gov.au/ACNC/Manage/Ongoing_Obs/ExtConduct_stds/ACNC/Edu/Ext_ConductStds.aspx>.
[189] Australian Charities and Not-for-profits Commission, *Protecting Your Charity Against the Risk of Terrorism Financing* (2015) <www.acnc.gov.au/ACNC/Manage/Protect/ProtectingTF/ACNC/Edu/ProtectTF.aspx>.

for overseas aid and development charities.[190] An ACNC report examining Australian charities involved in overseas activities showed that more than two thirds of charities involved overseas were classed as small (revenue less than AU$250,000), underscoring the importance of the ACNC providing continued guidance and education to these organisations.[191]

Under the *ACNC Act*, all registered charities must keep certain financial and operational records for seven years explaining the charity's financial position and activities.[192] The *ACNC Act* also makes provision for reporting requirements for registered charities (unless they are subject to an exception) through submission of an annual information statement (AIS) and financial reports.[193] Failure to submit an AIS results in penalties[194] and if this non-submission extends submit for two or more years, the ACNC may revoke registration. The AIS requires some information on cross-border charitable endeavours including whether the charity engaged in 'international activities' as a main or general activity (question 9), whether the charity's beneficiaries included 'communities overseas' (question 12), each country where the charity conducted activities or had beneficiaries during the reporting period (question 14) and the amount of grants and donations made by the charity for use outside Australia (question 18).[195]

ATO: Endorsement, Compliance Reviews and Audits

Once registered as a charity with the ACNC, the organisation can then be endorsed by the ATO to access income tax exemption and DGR status. As part of the endorsement process, the ATO assesses whether the charity meets the 'in Australia' residency and operational requirements (outlined above), as well as other conditions.[196] The ATO is also responsible (and prior to the establishment of the ACNC was solely responsible) for ensuring the tax compliance of charities through its review and auditing processes. For non-compliance, the ATO can revoke DGR and tax exempt status and impose penalties.

The Australian National Audit Office (ANAO) conducted a performance audit of the ATO's administration of DGRs immediately prior to the establishment of the ACNC, which found that the ATO faced a number of challenges in assessing the extent to which organisations complied with the requirements of their DGR status. The main challenges were associated with the limited resources available to properly assess the compliance risks associated with the sector and to undertake an appropriate level of post-endorsement compliance reviews and audits.[197] The signs are not encouraging for any increased oversight by the ATO of cross-border activities of Australian charities in the future. The Government's 2014 Budget announced staff reductions of 4700 from the ATO's workforce of 25 000 by 2017–18.[198]

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[190] Australian Charities and Not-for-profits Commission, *Factsheet: Overseas Aid and Development Charities* (2015) <https://www.acnc.gov.au/ACNC/FTS/Overseas_charities.aspx>.
[191] See Penny Knight and David Gilchrist, *Australian Charities Involved Overseas: A Study Supplementing the Australian Charities 2013 Report* (Curtin University Not-for-profit Initiative, 2015) <https://www.acnc.gov.au/ACNC/Pblctns/Rpts/OScharitiesreport/ACNC/Publications/Reports/OScharities.aspx?hkey=8c820399-65fe-4e53-99c9-79c83f2faa9c>.
[192] *ACNC Act* s 55-5. There are also record-keeping requirements in the tax laws.
[193] *ACNC Act* s 60-5.
[194] *ACNC Act* s 175-35.
[195] See Australian Charities and Not-for-profits Commission, Sample 2014 Annual Information Statement, <http://www.acnc.gov.au/ACNC/Manage/Reporting/2014Guide/ACNC/Report/2014AISGuide.aspx>.
[196] For endorsement as an income tax exempt entity, the charity must also (i) comply with the substantive requirements in its governing rules and (ii) apply its income and assets solely for the purpose for which it was established. For endorsement as a DGR, it must fall within a category of DGR described in sub-div 30-B of the *ITAA 1997*, having acceptable rules for transferring surplus gifts and deductible contributions on winding up or revocation of endorsement and maintain a gift fund. See *ITAA 1997* sub-div 30-BA.
[197] See Australian National Audit Office, 'Administration of Deductible Gift Recipients (Non-Profit Sector)' (Audit Report No 52, Australian Government, 2011) 20–21 [24] ('*ANAO Audit Report No 52*').
[198] Senate Economics Legislation Committee, *Answers to Questions on Notice, Budget Estimates 2014* (12 June 2014) <http://www.aph.gov.au/~/media/Committees/economics_ctte/estimates/bud_1415/Treasury/answers/BET2099-2106_Ludwig.pdf>.

DFAT: Overseas Aid Gift Deduction Scheme

As one of the limited exceptions to the 'in Australia' residency and operational requirements noted above, Australian organisations undertaking development and/or humanitarian assistance activities outside Australia can apply to establish an overseas aid fund under the Overseas Aid Gift Deduction Scheme (OAGDS) administered by DFAT. If the application is successful, the organisation can then apply to the ATO to be endorsed as a DGR under the general category of developing country relief fund.[199]

To qualify as an overseas aid fund under the OAGDS, the organisation must be registered as a charity with the ACNC, have a voluntary governing body, and be declared as an 'approved organisation' by the Minister for Foreign Affairs. To be an 'approved organisation', there are four criteria which must be met as assessed by DFAT: (i) the organisation delivers overseas aid activities (including development and/or humanitarian assistance) in developing countries[200]; (ii) the organisation has the capacity to manage and deliver overseas aid activities; (iii) overseas aid activities are delivered in partnership with in-country organisations, based on principles of cooperation, mutual respect and shared accountability; and (iv) the organisation has appropriate safeguards in place and manages risks associated with child protection and terrorism.[201] Once the organisation has been declared an 'approved organisation' by the Minister for Foreign Affairs, it must then put in place a public fund, administered by the ATO, which then needs to be approved by the Treasurer as a 'developing country relief fund'.[202]

As a result of the legislative and administrative requirements involved, only a limited number of organisations have succeeded in becoming a developing country relief fund: there were 235 at 31 October 2014, representing just 0.84% of all active DGRs.[203] However, once an organisation has achieved DGR status through this process there do not appear to be any ongoing compliance mechanisms.

DOE: Register of Environmental Organisations

Administered by the DOE in consultation with the ATO,[204] the Register of Environmental Organisations (REO) enables deductions for gifts made directly to an environmental organisation.[205] While the *ITAA 1997* does not specify that environmental organisations on the REO are able to operate outside Australia, the Commissioner of Taxation has taken the position that these environmental organisations do not need to have their purposes or beneficiaries in Australia; the only requirement is that 'the actual public fund must be in Australia'.[206]

For an organisation to be entered on the REO, the DOE undertakes an initial assessment to determine whether certain legal requirements are met, including that the organisation has a principal purpose of protecting and enhancing the natural environment or a significant aspect of it.[207] Once the DOE has determined that the applicant has met these requirements, it is passed to

[199] See Australian Taxation Office, *Income Tax: Overseas Aid Gift Deduction Scheme*, TR 95/2, 1 June 1995, [2]–[3], [4]–[6].
[200] See Department of Foreign Affairs and Trade, *List of Developing Countries as Declared by the Minister for Foreign Affairs* (February 2015) <http://dfat.gov.au/about-us/publications/Documents/list-developing-countries.pdf>. This list is based on the OECD DAC's list of countries and territories eligible to receive official development assistance (ODA).
[201] Department of Foreign Affairs and Trade, *Overseas Aid Gift Deduction Scheme: Guidelines* (February 2016) 8–15.
[202] For the ATO's requirements, see Department of Foreign Affairs and Trade, *Overseas Aid Gift Deduction Scheme: Guidelines* (February 2016) 17–19.
[203] Australian Taxation Office, *Taxation Statistics 2012–13: Charities* (8 April 2015) table 4 <https://data.gov.au/dataset/taxation-statistics-2012-13>.
[204] Australian Government, *Register of Environmental Organisations: A Commonwealth Tax Deductibility Scheme for Environmental Organisations – Guidelines* (2008).
[205] Explanatory Memorandum, Taxation Laws Amendment Bill (No 5) 1992, 43–44. See *ITAA 1997* s 30-55(1) item 6.1.1.
[206] See Australian Taxation Office, *Income Tax: Public Funds*, TR 95/27, 2 August 1995 [14].
[207] *ITAA 1997* s 30-265(1).

the Treasurer for approval.[208] These entry barriers have served to discourage qualifying organisations. As of 31 October 2014, there were 590 funds on the REO,[209] representing just over 2% of all active DGRs.[210] Once listed, these environmental organisations are required to submit an annual information statement,[211] including audited financial statements, providing some ongoing regulation.

In early 2015, at the behest of the Minister for the Environment, the House of Representatives Standing Committee on the Environment began an inquiry into the REO examining the administration and transparency of the REO, the activities undertaken by environmental DGRs and the compliance framework. The basis for the inquiry was to assure the public that tax concessions for environmental organisations were 'granted appropriately', particularly in light of the High Court decision *Aid/Watch Incorporated v Commissioner of Taxation*,[212] which found that Aid/Watch (an organisation on the REO) was permitted to engage in political debate and advocacy because there is no general doctrine in Australia that excludes political objects from charitable purposes. While these organisations' international activities were not a focus of the inquiry, the final report identified measures to 'strengthen the integrity of the tax-concessional arrangements for environmental organisations', including sanctions for environmental DGRs that support unlawful activities and abolishing the REO altogether.[213]

DFAT: Accreditation and Contractual Requirements in Grant Agreements

Following Canada's lead in amalgamating the Canadian International Development Agency (CIDA) and the Department of Foreign Affairs and International Trade, in 2014 the new Coalition Government integrated Australia's standalone aid agency, the Australian Agency for International Development (AusAID), into the Department of Foreign Affairs and Trade (DFAT). DFAT is now responsible for Australia's aid program on a significantly reduced budget.

The Australian NGO Cooperation Program (ANCP) is the largest Australian annual grants program that provides funding to accredited Australian NGOs to deliver projects in developing countries.[214] To be eligible to receive funding under the ANCP Australian NGOs must pass a rigorous accreditation process assessing their governance, program management capacity, and risk and partner management that is carried out by a team of independent assessors and can take up to nine months.[215] To be eligible for accreditation an organisation must (1) have DGR status under the OAGDS or be specifically listed by name in the *ITAA 1997* under the category of international affairs, (2) be a signatory to the ACFID Code of Conduct (see below), and (3) meet certain minimum activity and expenditure requirements.

More than 50 Australian NGOs have received accreditation under the ANCP.[216] To maintain accreditation, NGOs are re-accredited every five years and subject to a rolling program of audits

[208] See Australian Government, *Register of Environmental Organisations: A Commonwealth Tax Deductibility Scheme for Environmental Organisations – Guidelines* (2008) 4.
[209] Department of the Environment (Cth), *Register of Environmental Organisations* (17 August 2015) <http://www.environment.gov.au/system/files/pages/1fbfb20f-5749-4468-b008-feaf1804e969/files/register-environmental-organisations-2015.pdf>.
[210] Australian Taxation Office, *Taxation Statistics 2012–13: A Summary of Tax Returns for the 2012–13 Income Year and Other Reported Tax Information for the 2013–14 Financial Year* (2015) <https://data.gov.au/dataset/taxation-statistics-2012-13>, table 3.
[211] See eg, Department of the Environment, *Register of Environmental Organisations: 2013 Statistical Return* (2013) <http://www.environment.gov.au/system/files/pages/53ca6702-48ad-414a-bf24-60e253d5ad0d/files/statistical-return-2013.pdf>.
[212] [2010] HCA 42.
[213] See House of Representatives Standing Committee on the Environment, *Inquiry into the Register of Environmental Organisations* (April 2016) <http://www.aph.gov.au/Parliamentary_Business/Committees/House/Environment/REO/Report>.
[214] Other DFAT programs delivered through partnerships with NGOs include the Humanitarian Partnership Arrangement, the Africa Australia Community Engagement Scheme and the Civil Society Water, Sanitation and Hygiene Fund.
[215] See <http://dfat.gov.au/about-us/publications/aid/Pages/the-australian-ngo-cooperation-program-fact-sheet.aspx>.
[216] Department of Foreign Affairs and Trade, *DFAT and NGOs: Effective Development Partners* (December 2015) 5 <http://dfat.gov.au/about-us/publications/Documents/dfat-and-ngos-effective-development-partners.pdf>.

in the intervening period.[217] Funding under the ANCP is subject to the Commonwealth Grants Rules and Guidelines,[218] and implemented through a grant agreement, which contains provisions for ongoing monitoring and compliance, including annual reporting requirements through an online performance reporting system, the Monitoring, Evaluation and Learning Framework.[219]

B. Self-regulation

ACFID: Code of Conduct

ACFID is the peak body for Australian NFPs involved in international development and humanitarian action, with 128 full members. ACFID has developed a code of conduct to which its members must comply (the *'Code'*), to ensure appropriate governance and control and risk management mechanisms are in place.[220] The Code represents a voluntary, self-regulatory code of good practice for Australia's aid and development sector, which aims to increase transparency and accountability and encourage effective regulation. This is achieved through annual self-assessments and annual reporting requirements, whereby signatory organisations provide information demonstrating their continued compliance with the Code to an independent committee. This committee monitors adherence to the Code, investigates complaints and initiates corrective or disciplinary action for non-compliance, including suspending and revoking Code signatory status.

1.4.3 Jurisprudence

Two recent judicial decisions have had important implications for the regulation of international charitable endeavours, as they have widened the scope for Australian charities engaged overseas to obtain income tax exemption and gift deductible status. These decisions also precipitated the recent shift in the ATO's approach.

In *Federal Commissioner of Taxation v Word Investments Ltd*[221] the applicant (Word), was a fundraising arm that distributed funds to Wycliffe Bible Translators Australia, an Australian charity conducting missionary work overseas. Word applied for income tax exemption under the *ITAA 1997*, which was rejected by the ATO. The Commissioner argued that there were four issues precluding Word from receiving tax exempt status, one of which was that it did not meet the 'in Australia' residency and operational requirement for tax exemption that an entity have a physical presence in Australia and, to that extent, incur its expenditure and pursues its objectives principally in Australia. A majority of the High Court determined that Word met the 'in Australia' requirement, as it had a physical presence in Australia, incurred its expenditure and pursued its objectives principally in Australia; the decisions to pay were made in Australia, the payments were made in Australia to Australian organisations and its objectives included providing financial assistance to those organisations.

This finding that sending funds abroad through a suitably qualified organisation meets the 'in Australia' residency and operational requirement for tax exemption was affirmed in the recent Full Federal Court of Australia decision of *Federal Commissioner of Taxation v The Hunger Project Australia*,[222] which turned on the question of whether Hunger Project Australia ('HPA'), which operated primarily as a fundraising arm for a global network of entities that provided hunger relief in developing countries, qualified as an Australian public benevolent institution ('PBI') and

[217] See <http://dfat.gov.au/about-us/publications/Pages/australian-ngo-accreditation-guidance-manual.aspx>.
[218] See <http://www.finance.gov.au/resource-management/grants/>.
[219] Department of Foreign Affairs and Trade, *Evaluation of the Australian NGO Cooperation Program Final Report* (Office of Development Effectiveness, August 2015) 62 < https://dfat.gov.au/aid/how-we-measure-performance/ode/Documents/ode-evaluation-australian-ngo-cooperation-program-final-report.pdf>.
[220] See <https://acfid.asn.au/sites/site.acfid/files/resource_document/ACFID-Code-of-Conduct-vOCT14_0.pdf>.
[221] (2008) 236 CLR 204.
[222] (2014) 221 FCR 302.

was therefore eligible to apply for income tax exemption and DGR status.[223] The Federal Court determined that HPA was a PBI even though it sent all of its funds to entities overseas. While the Court did not explicitly consider the 'in Australia' residency and operational requirements, it found that '[t]he ordinary contemporary meaning or understanding of a public benevolent institution is broad enough to encompass an institution that raises funds for provision to associated entities for programs relieving hunger in the developing world'.[224]

In response to these decisions, the Australian Government proposed an initial Bill in 2012 to reform the tax laws applying to the geographic boundaries of both income tax exemption and gift deductibility,[225] which would serve to further limit the ability of Australian organisations and their donors to engage in tax deductible cross-border charitable endeavours. While the Bill lapsed when Parliament was dissolved ahead of a federal election, the incoming Government introduced its own draft Bill in 2014.[226] This Bill was expected to be before Parliament by early 2015, but has languished for the past two years, with the Government keeping a watching brief on the 'in Australia' residency and operational requirements as it awaits the ATO's public ruling.

1.4.4 Summary of Legal and Regulatory Framework

The legislative architecture in Australia adopted for the regulation of cross-border charity reflects a broader policy of imposing a flat prohibition on tax concessions for cross-border charitable endeavours, mitigated by special exemptions with high entry barriers. The 'in Australia' residency and operational requirements contained in Australia's tax legislation, as interpreted by the ATO, has served as a legislative tool for regulating the ability of Australian nonprofits and their donors to engage in international charitable work. Only certain classes of organisations that have been subjected to initial heavy vetting can engage in tax-effective cross-border charity. Recent judicial decisions have exposed a problem with this prescriptive 'red light' regulatory approach involving organisations using workarounds to circumvent these tax laws in order to engage in tax effective cross-border charitable endeavours.

For organisations that have succeeded in overcoming the high legislative barriers to entry, ongoing regulation is fragmented. This was underscored by the recent FATF assessment of Australia, indicating that Australia's 'red light' legislative measures are inadequate to address the challenges faced by NPOs operating overseas. While the ACNC is starting to provide guidance to these charities and collecting general information on overseas activities and expenditure through the AIS, there is scope for obtaining more specific data that should be utilised. Implementing the ECSs would enhance this oversight capacity.

For international development and relief organisations, the OAGDS provides little by way of ongoing regulation. Instead, ongoing regulation for these organisations, at least with respect to specific projects directed through the ANCP, is achieved through DFAT's accreditation process and grant agreements. The REO, which undertakes some ongoing regulation of environmental organisations that operate overseas, is under scrutiny by the current Government. Self-regulation of international aid and development organisations through ACFID has provided a strong 'green light' mechanism that promotes the efficient use of charitable resources and facilitates legitimate cross-border flows for these charities. The integration of ACFID's Code into the ACNC's governance standards and DFAT's accreditation process illustrates how government and sector-led regulatory mechanisms can work together.

[223] PBIs are charities that provide direct services to those in need of benevolent relief, or raise funds for the purpose of providing benevolent relief. See *ACNC Act* s 25-5(5) column 2, item 6.
[224] *Hunger Project* (2014) 221 FCR 302, 314 [66]–[67].
[225] Tax Laws Amendment (Special Conditions for Not-for-profit Concessions) Bill 2012 (Cth).
[226] Exposure Draft, Tax and Superannuation Laws Amendment (2014 Measures No 3) Bill 2014 (Cth): In Australia Special Conditions.

2. Findings

2.1 Evaluation of Approaches

The comparative analysis revealed a range of approaches to the problem of how to regulate the foreign activities of charities in a changed global landscape. In all of the jurisdictions examined there is a role for each of the three branches of government. Prescriptive statutory initiatives that govern the sector are undertaken by the legislature, which are subject to interpretation by the courts as cases arise. In practice, regulation of this sector – and, more specifically, of the subsector of charities operating internationally – is carried out by the executive agencies that are charged with implementation and enforcement.

To evaluate the approaches undertaken by these executive agencies to regulate the foreign activities of charities, this section examines the different regulatory tools or instruments used in each jurisdiction. These tools represent a broad spectrum of red and green light measures that seek to address the specific objectives of mitigating the risk of charities operating overseas being misused for terrorist financing and limiting the tax concessions to their charitable purpose, while encouraging the efficient use of charitable resources and facilitating legitimate cross-border flows of charity.

2.1.1 Legislative Measures

The legislative measures adopted across all four jurisdictions examined provide a means of prescriptive 'red light' regulation to prevent the abuse of charities and misuse of charitable funds. In addition to legislation strengthening terrorist financing measures since the 2001 terrorist attacks, each jurisdiction has provisions in its tax legislation containing geographic limitations on the ability of charities to engage in charitable endeavours overseas. The interpretation of these provisions by the tax authorities and the courts, have impacted the ability of charities and their donors to engage in international charitable work.

Australia's *ITAA 1997* contains the 'in Australia' residency and operational requirements for income tax exemption and gift deductible status, which as currently interpreted by the ATO restricts the ability of Australian charities and their donors to engage in overseas charitable endeavours. The Australian courts have taken a far more permissive approach to the foreign activities of Australian charities and this appears to have caused a shift in approach by the ATO that is yet to be officially adopted.

While the UK legislation does not contain provisions that explicitly limit the foreign activities of charities, the Finance Act contains jurisdiction, registration and management structural requirements, which serve to limit access to UK charitable status and tax relief. It also provides that UK charities submit to a reasonableness determination by HMRC prior to sending charitable funds overseas, evidencing that they have engaged in control over the funds. These restrictions have served to undermine the permissive approach undertaken by the ECJ towards cross-border charity.

While there are no geographic limitations on income tax exemption in the IRC, the 'in US' requirement for deductibility of charitable contributions does not permit a tax deduction for charitable contributions made directly to foreign charities. The IRS allows a deduction if a donation to a US charity is used for charitable work abroad in furtherance of its mission or if the donation is made through a US charitable intermediary, provided it exercises 'control and discretion'. The US Tax Court has generally adopted a more permissive approach to the foreign activities of charities.

In Canada, foreign-based entities generally cannot be registered as charities because of the 'in Canada' residency requirement contained in the definition of registered charity in the ITA. In addition, the ITA defines a charitable organisation as having all of its resources devoted to charitable activities carried on by the organisation itself. The CRA has interpreted this provision to mean that these organisations can only use their resources overseas through gifts to 'qualified donees' or by carrying on their 'own activities', which requires meeting significant 'direction and control' requirements over the use of funds. This restrictive approach has been upheld by the Canadian Federal Court of Appeal.

The geographic limitations in the tax legislation and their interpretation by the tax authorities and the courts are summarised in table 2.1 below.

Table 2.1 Geographic restrictions in tax legislation and their interpretation

Country	**Legislative provisions with geographic limitations**	**Interpretation of legislative provisions by tax authorities***	**Interpretation of legislative provisions by the courts***
Australia	'In Australia' residency and operational requirements for income tax exemption and gift deductible status (*ITAA 1997*)	Restrictive (but under review)	Permissive
UK	Indirectly through jurisdiction, registration and management structural requirements and reasonableness determination for charitable tax relief (*Finance Act*)	Restrictive	Permissive (ECJ)
US	'In United States' residency requirement for deductibility of charitable contributions (*IRC*)	Generally restrictive	Generally permissive
Canada	'In Canada' residency requirement for charitable status and tax relief (*ITA*)	Restrictive	Restrictive

* This is assessed based on the extent to which the statutory interpretation would permit or restrict charities and their donors to engage in cross-border charitable endeavours.

2.1.2 Regulatory Measures

Regulatory Measures for Charities Generally

Governments in the jurisdictions examined have introduced a range of tools to regulate charities, whether by the charity regulator, the tax authorities or both. These include requirements to be registered as a charity, followed by ongoing compliance measures once charitable status has been obtained. These tools are summarised in table 2.2 below.

Table 2.2 Tools to Regulate Charities Generally

Mechanisms **Country**	**Registration requirements**	**Governance standards**	**Reporting requirements**	**Record-keeping requirements**	**Inquiries/ compliance reviews/audits***
Australia	- ACNC: registration (including governance standards) - ATO endorsement for tax concessions	ACNC: governance standards	ACNC: annual information statement	ACNC: 7 years	ACNC: minimal compliance reviews ATO: minimal inquiries/audits
UK	Charity Commission & HMRC registration	None	Charity Commission: Annual return	Charity Commission: 6 years	Charity Commission: extensive inquiries (under new legislation) HMRC: minimal inquiries/audits
US	IRS registration	None	IRS: Form 990	IRS: 3 years	IRS: minimal inquiries/audits
Canada	CRA registration	None	CRA: annual information return	CRA: 6 years	CRA: extensive inquiries/audits

***** The scale on which these are assessed ranges from minimal to extensive, based on the number undertaken.

Regulatory Measures Specifically for Charities Operating Overseas

Governments in the jurisdictions examined have introduced a combination of 'red light' and 'green light' tools to specifically regulate the foreign activities of charities. Many of these compliance measures have been introduced as part of the process for registration as a charity. Other measures are triggered once charitable status has been obtained through additional reporting requirements or the imposition of strict 'red light' control requirements. All of the jurisdictions provide strong 'green light' regulation through guidance on issues involving charities carrying out international activities. International aid and development charities are subject to further government regulation through various screening processes required to be eligible for government funding and through contractual requirements in their grant agreements with these agencies. The additional tools used to regulate the foreign activities of charities are summarised in table 2.3 below.

Table 2.3 Specific tools to regulate charities operating overseas

Tools Country	Additional application or registration requirements	Additional reporting requirements	Control requirements	Guidance for charities operating internationally	Additional inquiries & audits	Contractual requirements/screening processes for gov't grants
Australia	- ACNC: additional questions upon registration - OADGS - External conduct standards (not yet implemented) - REO	- ACNC: minimal information in annual information statement - REO: annual return	None (may be included in external conduct standards if implemented)	ACNC: minimal	No	DFAT/ accreditation
UK	HMRC: jurisdiction requirement for foreign (European) charities	Charity Commission: minimal information in annual return	HMRC: extensive control requirements when sending funds overseas to enable HMRC to make a reasonableness determination	Charity Commission: extensive	Charity Commission & HMRC: charities selected on risk basis including terrorist financing	DFID/none
US	- IRS: additional questions upon registration - US Treasury: Anti-Terrorist Financing Guidelines & Specially Designated Nationals List	IRS: extensive information in Form 990	IRS: minimal control requirements for public charities sending funds overseas; more extensive for private foundations (expenditure responsibility & equivalency determination)	IRS: minimal	No	USAID/ registration requirements
Canada	- CRA: compliance with anti-terrorism legislation	CRA: quite extensive information in annual information return	CRA: extensive control require-ments when working with intermediaries overseas	CRA: extensive	No	Global Affairs/ institutional profile

2.1.3 Self-regulation

International aid and development charities are subject to 'green light' self-regulation through the peak bodies for NFPs involved in international aid and development. All of these organisations have some overriding document of principles for their members, with most undertaking a greater regulatory role by requiring periodic self-assessments or accreditation process by members and imposing reporting requirements, with consequences for non-compliance. Table 2.4 outlines the different self-regulatory mechanisms used in the four jurisdictions.

Table 2.4 Sector-driven self-regulatory mechanisms for international development charities

Mechanisms **Country**	**Code of Conduct/Standards/ Charter**	**Self-assessment/ accreditation**	**Reporting requirements**	**Consequences for non-compliance**
Australia	ACFID Code of Conduct	ACFID: self-assessment	ACFID: annual reports	ACFID: suspending or revoking Code signatory status
UK	Bond Charter	None	None	None
US	InterAction Standards	InterAction: self-assessment	InterAction: completion of compliance form every 2 years	InterAction: suspension of membership or denial of membership application
Canada	- CCIC Code of Ethics and Operational Standards - Imagine Canada: Standards Program	- CCIC: self-assessment - Imagine Canada: accreditation	- CCIC: renewal of compliance every 3 years - Imagine Canada: annual compliance report	- CCIC: suspension of membership or denial of membership application - Imagine Canada: loss of accreditation

2.2 Key Trends

The findings from the comparative analysis revealed a number of key trends:

- Tax authorities across the four jurisdictions have generally taken a restrictive 'red light' interpretation of the geographic limitations contained in their tax legislation, which has served to constrain the foreign activities of charities and their donors.
- Other than Canada, the courts have generally adopted a permissive 'green light' approach to the foreign activities of charities. The Canadian Court of Appeal has resisted this trend and instead sanctioned the CRA's restrictive approach.
- Across all jurisdictions there has been a proactive use of tools by government to regulate the foreign activities of charities. In Canada, the UK, and the US, there is an emphasis on ongoing regulation through strict 'red light' control measures. Canada appears to be both the most prescriptive in terms of the CRA's interpretation of 'direction and control', as well as enforcement through audits.
- International aid and development charities in Australia, the US and Canada are subject to particularly stringent screening processes in order to obtain government grants, and government agencies across all four jurisdictions regulate the activities of these charities

through their grant agreements, which contains provisions for ongoing monitoring and compliance.

- Outside of government regulation, there is robust self-regulation through peak bodies for the international development sector. In Canada, the US and Australia, these self-regulatory mechanisms adopted have rigorous ongoing compliance measures, as well as consequences for non-compliance.

The findings from the comparative analysis also revealed that relative to the regulatory constraints on the foreign activities of charities in the other common law jurisdictions examined, the restrictions placed on Canadian registered charities are particularly onerous. The Canadian restrictions stem from both the provisions of the *ITA* that limit how registered charities can operate, the interpretation of these provisions by the courts, and the prescriptive regulatory approach adopted by the CRA. This regulatory regime, focused primarily on 'red light' measures to prevent undesirable consequences from international charitable endeavours has impeded the ability of Canadian charities and their donors to effectively engage in charitable work outside Canada. The result is over-regulation of charities operating outside Canada, placing a disproportionate burden on charities that are not at risk and stifling legitimate cross-border charitable endeavours.

3. Conclusion and Recommendations

More than a decade has passed since the September 11 terrorist attacks and it has become clear that the initial reaction by governments around the world and the Financial Action Task Force (FATF) to the charitable sector's vulnerability to misuse by terrorists was overstated. The Financial Action Task Force (FATF) has amended Recommendation 8 as the international standard for charities working across borders to reflect this evolved understanding of the global charitable landscape. National governments have retained restrictive legislative and regulatory 'red light' measures for charities operating overseas in response to the perceived threat. It is now timely for them to consider adopting a more measured and mature approach to regulating the foreign activities of charities. For Canada in particular, the Federal Government's mandate letters provide an opportunity to modernise the regulatory framework for charities operating outside Canada.

3.1 Key Recommendations

Should the Canadian Government ultimately decide to adopt a new regulatory approach to the foreign activities of charities, the findings from the comparative analysis provide a principled basis for reform. Integral to this reform are the following key recommendations that address the weaknesses in Canada's prescriptive regulatory approach.

Apply a risk-based approach to regulation

Following the new approach taken by FATF in its revised Recommendation 8, the CRA needs to re-evaluate its 'one-size-fits-all' regulatory approach that impacts the entire nonprofit sector operating overseas. Instead, the CRA should adopt a risk-based approach, focusing its efforts on targeting and monitoring of charities with a heightened risk of terrorist abuse. Such an approach involves the application of proportionate measures to those charities that have been identified as being most at risk of misuse. This requires prioritising of regulatory actions and resources in accordance with an assessment of the risks posed by charities working internationally. Conducting a national risk assessment would be an important first step. Following the risk-based approach taken by the Charity Commission and HMRC, it should also ensure that its audits target at-risk charities.

Adopt a less restrictive approach to the 'in Canada' residency requirement

Both the CRA and the courts could take a less restrictive interpretation of the 'in Canada' residency requirement in the *ITA*. The ATO's shift in approach in Australia exemplifies the possibility of adopting a different interpretation of the tax legislation. One interpretation that has been canvassed by the intervener in *Public Television* is expanding the 'charitable goods policy' to make it the rule rather than the exception for 'direction and control'. This would still require appropriate measures to be undertaken to ensure that charitable funds sent overseas would only be used for the intended charitable purpose, similar to those undertaken by US public charities. At a minimum this would involve the charity conducting due diligence to be reasonably sure that the grant will be used for its charitable purpose; entering into a written agreement regarding the intended use of funds; and undertaking appropriate monitoring to ensure that the funds are used for approved charitable purposes.

Remove excessive 'direction and control' requirements and replace with other regulatory measures

While all of the countries examined impose additional oversight measures for charities operating overseas, Canada's strict 'red light' control requirements are exceptional. These requirements create additional red tape and compliance costs for Canadian charities working abroad. At best this uses up scarce charitable resources that could otherwise be directed to people in need around the world. At worst it discourages charities from working outside Canada, particularly for small and medium sized charities without sufficient resources to spend on these compliance obligations. There are other regulatory measures that could be employed to ensure that charitable funds are being used to pursue legitimate charitable purposes overseas without requiring charities to comply with such excessive control requirements. For example, like the IRS, the CRA could require additional information upon registration specifically directed at charities operating outside Canada.

At a minimum, it is recommended that the CRA remove the more onerous 'direction and control' requirements to reduce administrative burdens and compliance costs for charities. Specific requirements to be removed include:

- Maintaining original source documents in Canada to verify that the charity's funds have been spent on its own activities and the charity is directing and controlling the use of its resources. This requirement is not practically viable or realistic. In many countries it is not possible to remove original documents. Instead, the requirement should be based on the ability to access the documents in Canada, which can be achieved by keeping electronic copies of documents.
- Foreign intermediaries keeping the charity's funds separate from its own. Again, this requirement is often not practical in many countries. Instead oversight can be achieved by segregating funds from an accounting perspective, by using separate ledgers.

Reduce overlap between regulatory bodies overseeing international charitable endeavours

There are a number of different Canadian agencies involved in regulating the foreign activities of charities, resulting in over-regulation of the sector. Reducing some of the overlap that exists between these agencies could help reduce the administrative burden and costs for charities operating overseas. International aid and development charities in particular are required to submit an NGO Institutional Profile to Global Affairs for review, demonstrating that they meet a number of requirements, and are subject to oversight once funding is provided through grant agreements. These organisations are also likely to be members of CCIC and/or Imagine Canada, and thereby subject to self-assessment pursuant to CCIC's Code of Ethics and Operational

Standards and accreditation through Imagine Canada's Standards Program. As demonstrated in Australia, for international aid and development charities that are in compliance with these self-regulatory standards, the CRA could follow ACNC and Global Affairs could follow DFAT by integrating these standards into their registration process and institutional profile, respectively.

3.2 Concluding Comment

In a world in which charity increasingly cross borders, it is critical that government regulation of the foreign activities of charities effectively and proportionately addresses the vulnerabilities and risks in the sub-sector of charities operating internationally, while minimising the regulatory burden and facilitating legitimate cross-border flows of charity. This report offers a comparative perspective and a pragmatic way forward for Canadian policymakers and other stakeholders to achieving a better balance between these competing policy considerations.

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