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Charitable Contributions: A Legal Money Laundering System

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Abstract

Elon Musk tweeted on October 31, 2021, "If WFP can describe on this Twitter thread exactly how $6B will solve world hunger, I will sell Tesla stock right now and do it. But it must be open source accounting, so the public sees precisely how they spend the money." The WFP is a major U.S.-based non-profit organization focusing on humanitarian work and determining what is considered a charitable nonprofit. There are five types of nonprofits: charitable nonprofits, title-holding trust corporations, community welfare organizations, veterans organizations, and civic league organizations. The media has increasingly highlighted the lack of transparency in how nonprofits manage their wealth. Many organization leaders are called out for misuse of funds and living lavish lifestyles. Yet, organizations such as the Cancer Fund of America or the Bill and Melinda Gates Foundation are omitted from scrutiny. Who is holding organizations responsible for their financial practices and ensuring they use the money for its marketed purpose?

For this project, I intend to engage and inform the public about how nonprofits operate, how the cash flows through the system, and where it ends up. It is an important topic because it needs to be more widely discussed, and I hope it brings more attention and scrutiny to how charitable funds are utilized.

Introduction

Spiked Interest

My interest in this topic was spiked by a tweet by the CEO and owner of Tesla, Elon Musk, on October 31, 2021, which stated, “If WFP can describe on this Twitter thread exactly how $6B will solve world hunger, I will sell Tesla stock right now and do it. But it must be open source accounting, so the public sees precisely how they spend the money.” The WFP is a major U.S.-based non-profit organization focusing on humanitarian work and determining what is considered a charitable nonprofit. The tweet spiked my interest as I am majoring in accounting and have worked as an accountant since 2019. So I have had experience working with charitable organizations and contributions, whether from an individual or an organization. I have had the opportunity to see how people benefit from being contributors and the amount of benefit they receive not only depends on their contributions but also their income level. Development in the charity sector is diverse in different countries and is expected to continue growing, as many nations recognize this sector's significant role in a well-functioning society. This led me to reflect on my experience working with an NGO in Cape Town, South Africa, for my virtual internship in the summer of 2021. During this experience, we planned out ways for the new community center in one of the shanty towns. During this planning, we had to lay out how it would function and how this would bring a return for the investors that the organization leader could present. The subject of return on a charitable investment led me to ponder how you can generate revenue on something that is meant to be a non for profit organization and whether these funds are intended to be seen as donations or investments into the organization. How is this money accounted for, and what is the flow? I needed more transparency as we only discussed the surface level of making the plan appealing to contributors/investors. Is it because of status within the organization?

Why does it matter?

This system has created an environment for wealth hiding. Billionaires can use philanthropic giving to whitewash their reputations and avoid taxation. Understanding how this system works, not only in the U.S. but also in the rest of the world, and what the true outcomes of the system are will bring more attention to it, which could help lead to reform and change for a better system that does what it is truly meant to do. Philanthropy experts fear that the utilization of these tax havens for the wealthy will increase the amount of money being siphoned away from charitable causes and would rather create these tax-free “savings accounts”. As stated by the EFA, which is the European Fundraising Association, in their December 2018 Tax Survey Report, “Tax incentives can have a major impact in charitable giving and the overarching culture of philanthropy within a nation. It’s not simply a case of any tax relief being a financial incentive to those that donate but providing a strong and coherent message that the Government recognizes the key role of charities and nonprofits, encouraging the public to donate.”

Regulations

United States

Private foundations are required to spend a minimum of 5 percent of their assets per year, whereas DAFs (Donor Advised Funds) do not have any requirements and the assets are untaxed. Individuals can avoid paying capital gains with DAFs by denoting shares, which become deductions for them on their taxes. DAFs are not required to state where their contributions are going or what amount. Private family foundations are tax-exempt but are subject to complex tax regulations, and the creators receive tax deductions for contributions. A foundation generally distributes funds as grants to individuals or other charities, which must be disclosed in their annual IRS filings. Your deduction for charitable contributions generally can't be more than 60% of your AGI (Adjusted Gross Income), but in some cases, 20%, 30%, or 50% limits may apply. On September 29, 2022, the IRS stated “The IRS reminds donors that contributions to foreign organizations generally are not deductible.”

Europe

The EFA states “While the large majority of European nations offer tax incentives to encourage charitable giving, there is a huge amount of variance in terms of the type of incentive available, how it is allocated, and any restrictions that apply.” Charities in six European nations are formally required to provide information about donors or the donations they have received to the tax authorities. Charities in the remaining five nations are only required to provide donation receipts or statements to supporters, giving them evidence to support their claim for tax relief or payment.

Sweden and Finland

Only Sweden and Finland have no mainstream tax incentives in place for charitable donations from individuals, although Finland does offer a limited scheme that enables the public to benefit from tax relief when giving to select science or arts universities in the EU. In the case of donations to universities, individuals and companies receive tax incentives for giving between 850 EUR ($927) and 500,000 EUR ($545,470). Only companies can claim a deduction on donations beneath the 850 EUR threshold.

Norway

Norway caps tax-effective donations at a total of 40,000 NOK ($3,885). Charities are required to register for approval to receive such gifts and must submit details of donations to the tax authorities, with donor permission, for them to access the tax break.

Austria

In Austria, tax incentives are currently restricted to just a few causes. Charities are required by law to identify private donors by name and date of birth and to report their donation to the tax authority for the deduction.

Slovenia, Slovakia, and Netherlands

In Slovenia, the public can choose from an array of charitable causes when giving, they can only allocate 0.5% of their income tax to good causes each year. Only charities in Slovakia, Slovenia, and the Netherlands are not required to provide any information to the tax authority or to donors themselves to process the incentive.

Italy, the United Kingdom, and Ireland

In Italy an assortment of tax incentive schemes is available and the UK offers the most inclusive scheme, requiring no minimum donation or cap on contributions. Ireland offers a particularly high cap of €1,000,000 ($1,090,350) on tax-effective donations and a minimum donation of 250 EUR ($273) is required. The UK and Ireland must file a tax claim to process the tax payment for themselves. In the UK the charity is not typically required to provide information to support a higher-rate taxpayer's claim for additional tax relief.

Germany

Individuals in Germany can deduct up to 20 percent of their pre-tax income as a donation to any non-profit organization, so long as it is recognized by the tax office. In Germany, receipts are only required on donations exceeding 200 EUR ($218). There is no formal interaction required between charities and tax authorities.

Who is affected?

An average American pays an estimated 10 percent in federal taxes yearly, while the elites only pay a ‘true tax rate’ of 3.4 percent, which is a rate that is achieved through charitable donations. DAFs are being increasingly utilized by the wealthy due to the fact that they are keeping the benefits of philanthropy while delaying for years donating anything to those who need it.

Slovakia and Slovenia both operate a percentage allocation scheme, with the donation and tax benefit being allocated to the charity by the tax office when the donor completes their tax return. Therefore, the tax office already has information about donations and it is charities that are often in the dark about the source of their giving. However, in the UK the incentive mainly benefits the charity rather than the contributor and a similar system exist in Ireland. Tax incentives are more widely available for companies than individuals.

Literature Review

Harris, E., Petrovits, C., & Yetman, M. H. (2017). Why bad things happen to good organizations: The link between governance and asset diversions in public charities. Journal of Business Ethics, 146, 149-166.

The article explores the relationship between governance and asset diversions in public charities. It argues that good governance, particularly in the areas of board composition and oversight, can help prevent asset diversions. The authors suggest that a lack of diversity on boards and weak oversight can create an environment where asset diversions are more likely to occur. They also argue that certain organizational characteristics, such as size and age, can contribute to a higher risk of asset diversions. The article highlights the importance of good governance practices in ensuring that public charities remain accountable and transparent in their operations.

Ohalehi, P. (2019). Fraud in small charities: evidence from England and Wales. Journal of Financial Crime, 26(1), 211-222.

The article examines fraud in small charities in England and Wales. It highlights the prevalence of fraud in small charities and the challenges that they face in preventing and detecting it. The author argues that the lack of resources and expertise, coupled with a culture of trust, can make small charities vulnerable to fraud. The article also identifies the types of fraud that are most common in small charities, such as theft of cash and misuse of funds. The author suggests that implementing proper internal controls and training staff and volunteers can help prevent fraud in small charities. The article emphasizes the need for small charities to be vigilant and take proactive steps to prevent fraud in order to maintain the trust and confidence of their stakeholders.

Greenlee, J., Fischer, M., Gordon, T., & Keating, E. (2007). An investigation of fraud in nonprofit organizations: Occurrences and deterrents. Nonprofit and voluntary sector quarterly, 36(4), 676-694.

The article investigates the occurrence of fraud in nonprofit organizations and the factors that can deter it. The authors found that fraud is a prevalent issue in the nonprofit sector, with financial fraud being the most common type. The article identifies factors that may contribute to the occurrence of fraud, such as weak internal controls, lack of oversight, and the presence of opportunities for fraud. The authors also explore the effectiveness of various deterrents, including strong leadership, transparency, and accountability, and suggest that these factors can play a significant role in preventing fraud in nonprofits. Additionally, the article highlights the importance of creating a culture of ethics and integrity within nonprofit organizations as a key deterrent to fraud. The authors conclude by emphasizing the need for nonprofit organizations to prioritize the implementation of strong internal controls and other measures to prevent and detect fraud.

Case Example

Nicholas Woodman, CEO of GoPro

Millionaire CEO and founder of GoPro, Nicholas Woodman, donated $500 million to a DAF in 2014, which was the same year his company went public and earned $3 billion in stock. According to an investigation by the *New York Times* in 2018, there was only one public record of a donation from this DAF account, of an unspecified amount, to a fundraiser called “The Bonny Doon Art, Wine, and Brew Festival.” This festival is held annually during June and is presented by the Bonny Doon Community Schools Foundation, which is a non-profit organization that has worked for over 20 years to support public education in Bonny Doon, CA. It seems to be a reasonable assumption that the $500 million in the fund was not all donated that day. Placing their $500 million into this fund, allowed them to avoid an estimated $450 million in long-term capital gain taxes.

Sam Bankman-Fried, CEO of FTX

In 2021, Sam Bankman-Fried, the founder and CEO of the cryptocurrency exchange FTX, announced that he would donate the majority of his wealth to charity. Specifically, Bankman-Fried pledged to donate at least $1 billion to effective causes over his lifetime, with a focus on reducing global catastrophic risks and promoting effective animal welfare. This pledge is significant not only for the amount of money involved but also because it reflects a growing trend among business leaders to prioritize philanthropy and social impact in their work. Bankman-Fried has stated that he sees his wealth as a means to an end, rather than an end in itself, and that he wants to use his resources to help make the world a better place. As of recently, there is no evidence that Sam Bankman-Fried has made any significant donations towards his philanthropic pledge.

Kids Company in the UK

One example of fraudulent charitable activity internationally is the case of the Kids Company in the United Kingdom. The Kids Company was a charity organization that provided services to vulnerable children and young people. However, it was later revealed that the charity had been engaging in financial mismanagement and misconduct, which led to its closure in 2015. An investigation by the UK government's Public Administration and Constitutional Affairs Committee found that the charity had been run in an unsustainable way, with inadequate financial controls and poor governance. The investigation also found that the charity had been misusing funds, including government grants, to pay for inappropriate and excessive expenses such as staff salaries, rent, and utilities. The collapse of the Kids Company led to criticism of the charity sector in the UK and calls for tighter regulation of charities to prevent fraudulent activity. The case also highlights the importance of transparency and accountability in the charity sector, as well as the need for donors and supporters to research and vet charitable organizations before making donations.

Solutions

New and stricter regulations for nonprofits would eliminate the grey areas for contributions and where they are going. An increase in transparency will remove the philanthropic mask that has been placed on so many so that we may know who the true givers are, such as in European countries where they require more documentation and proof of giving. As well as an increase in transparency, an increase in requirements for giving is necessary as well, with DAFs having no minimum requirement and private foundations having only a minimum 5 percent requirement, which allows billions of dollars to go untaxed. New regulations could unlock the pool of almost $1.5 trillion, which is marked for good causes but relatively impossible for nonprofits to access.

Improvement in government systems and assistance so that there isn't as much of a need for nonprofits. Rather than giving such high deductions for contributions, put money being taxed in government assistance programs. Sweden and Finland are two EU countries that do not offer mainstream tax incentives for charitable donations but rather direct the tax benefit to the charity rather than the donor. The mentality, when it comes to charities, is that they step in where the government fails so if there were reform on current systems and an introduction of new systems then the necessity of charities and donations would decrease.

Conclusion

Nonprofits being used as tax havens for the wealthy are more prevalent in the United States and the United Kingdom due to government regulations, with the United States allowing for the most tax breaks and loopholes for individuals, specifically wealthy ones. Wealthy individuals utilize these systems, specifically DAFs in the U.S., to 'hide' money and prevent it from being taxed, all the while they receive the title of being philanthropist and applause from the public. Private foundations have a minimum requirement of 5 percent expenditure of assets, meanwhile, the 95 percent of assets that are being held are tax exempt, and this is yet another way for the wealthy to 'hide' their money behind a philanthropic title while not helping anyone. Many private foundations meet the minimum donation requirement by contributing it to a DAF.

Some potential implications of using charitable contributions as a form of legal money laundering or wealth hiding are erosion of public trust, negative impact of the charitable sector, legal and regulatory consequences, negative impact on society, and a need for increased transparency and accountability. If charitable organizations are seen as complicit in helping individuals conceal illicit funds or hide their wealth, this could lead to a decline in donations and support for legitimate charitable causes.If wealthy individuals are using charitable donations as a way to launder money or hide their wealth, this could result in an influx of tainted money into the charitable sector. This could damage the integrity of the sector and make it more difficult for legitimate organizations to obtain funding. If individuals are found to be using charitable donations for illegal purposes, they could face legal and regulatory consequences, such as fines or imprisonment. Charitable organizations could also face sanctions or legal action if they are found to have knowingly facilitated such activities. If individuals are found to be using charitable donations for illegal purposes, they could face legal and regulatory consequences, such as fines or imprisonment. Charitable organizations could also face sanctions or legal action if they are found to have knowingly facilitated such activities. In order to mitigate the risks associated with the misuse of charitable contributions, there may be a need for increased transparency and accountability in the charitable sector. This could include increased regulatory oversight, stronger reporting requirements, and greater scrutiny of the sources of donations.

In conclusion, the use of charitable contributions as a form of legal money laundering or wealth hiding has significant implications for the charitable sector and society as a whole. Such practices can erode public trust, damage the integrity of the charitable sector, result in legal and regulatory consequences, negatively impact society, and create a need for increased transparency and accountability. It is important for charitable organizations, regulators, and governments to take steps to mitigate the risks associated with the misuse of charitable contributions. This could include implementing stronger reporting requirements, increasing regulatory oversight, and improving due diligence processes for donations. Furthermore, it is important to recognize the importance of charitable contributions as a means of supporting legitimate charitable causes and making a positive impact in society. While there are risks associated with the use of charitable donations for money laundering or wealth hiding, it is crucial to ensure that legitimate charitable organizations continue to receive the support they need to carry out their important work. A balance must be struck between protecting against the misuse of charitable contributions and ensuring that legitimate charitable causes continue to receive the support they need to make a positive impact in society.

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Appendix

Statistics

United States

In 2021, the largest source of charitable giving came from individuals, who gave $326.87 billion, representing 67 percent of total giving. In 2021, the majority of charitable dollars that were given, 27 percent went to religion, 14 percent to education, 13 percent to human services, 13 percent to grantmaking foundations, and 11 percent to public-society benefits. Giving in 2021 increased in nearly every sector, with double-digit growth in gifts for arts, culture, and humanities of 27.5 percent, public-society benefits at 23.5 percent, and environment and animals at 11 percent. Since 1980 the rich have increased the wealth gap 19 times what it was, and one-third of that occurred during the pandemic. The average citizen's income has only increased by less than 50 percent since 1970.

Individual

Americans gave $484.85 billion in 2021, which is a 4 percent increase from 2020. 86 percent of affluent households maintained or increased their giving despite uncertainty about the further spread of COVID-19. Adults are statistically more likely to give to charity if their parents gave to charities as well. An estimated 30 percent of US adults, 77.9 million Americans, volunteered in 2019, contributing an estimated 5.8 billion hours, valued at approximately $147 billion.

Corporations

Corporate giving in 2021 increased to $21.08 billion, which is a 23.8 percent increase from 2020. Corporate giving was bolstered by $405 million in contributions related to disaster relief. Only 1.31 percent of individual donations are matched at the average nonprofit, despite more than 10 percent is eligible for corporate matching. 80 percent of nonprofits said they have difficulty building strong corporate partnerships and workplace-giving strategies with limited staff and resources. 85 percent of companies in the US have a formal domestic corporate giving program in place vs. only 45 percent with a formal international program. 7 out of 10 companies give to recipients abroad.

Organizations

There are more than 1.54 million charitable organizations in the United States. Foundation giving in 2021 increased to $90.88 billion, which is a 3.4 percent increase from 2020. The top four national volunteer activities are 36 percent of fundraising or selling items to raise money, 34.2 percent of food collection or distribution, 26.5 percent of collecting, making, or distributing clothing, crafts, or other goods, and 26.2 percent of mentoring youth. The top four types of organizations by volunteering are 32 percent of religious, 25.7 percent of sport, hobby, cultural or arts, 19.2 percent of educational or youth service, and 6.2 percent civic, political, professional, or international.

Donor-Advised Funds

There were 1,285,801 donor-advised fund accounts in 2021, which is a 27.6 percent increase from 2020. Donor-advised funds held $234.06 billion in charitable assets in 2021, which is a 39.5 percent change from 2020. Annual contributions into donor-advised funds were $72.67 billion in 2021, which is a 46.6 percent increase from 2020. The average fund size is $182.84 billion in 2021, an increase of 9 percent from 2020. The payout rate of these funds is only 27.3 percent.

Europe

In the EU almost all nations (15 out of 16) give businesses tax relief on donations. 14 out of 16 European nations offer tax incentives for individual donations to charity. 2 nations direct the tax benefit to the charity rather than the donor. Personal tax incentives are usually capped at 10 to 20 percent of taxable income. 7 out of 14 of the nations that offer tax incentives apply a minimum sum at which donations become eligible for tax relief, which is typically a low baseline (under EUR 100 annually), with the exception of Ireland.

Austria

Deduction for donations only applies on gifts to 5 percent of organizations, 6,500 of all 123,000 charities and foundations combined, 5,200 of which include fire brigades and charities working to support social causes, science, arts, culture, and conservation. 18 percent of Austrian taxpayers donate through endowments to foundations.

Norway

Tax-effective giving in Norway has more than doubled since 2005, with almost 3.5 billion NOK ($340,453,750) donated in this way in 2015. Tax-effective giving is donating in a way that is beneficial to your taxes by being a deduction.