

Chapter 6

Payments Through Illegal and Disguised Means, and Misuse of NGOs, Trusts, Associations and Foundations

There have been many initiatives in fighting the war on organized crime. In Mexico, for example, the war on drugs has had a central focus, with strategies built on the involvement of civil and military agents, setting records for cash forfeitures, drugs apprehended and extraditions. On September 10, 2007, in the Municipality of Zarzal in the northeastern part of the Department of Valle, the Colombian army captured Diego Montoya, better known as Don Diego, one of the ten most wanted criminals on the DEA, CIA and FBI lists. According to Juan Carlos Garzón, this arrest was probably the most notable achievement in the war on drugs for that year, in which over 57,000 people were arrested, with over 100 of them extradited to the United States.¹

Eric Olson explains that there are many similarities between Italian Mafia organizations and Mexican criminal gangs. In his view, “Mexican organized crime is more market-focused, less stable, and less durable. Moreover, Mexican criminal organizations are much more willing to attack the state. Additionally, the violence they use is more gruesome and has different goals, including intimidating their rivals and terrorizing the public. Finally, they seek to shape public perceptions about organized crime by targeting the media either through violence and intimidation, or controlling the stories that are published.”²

What was once considered extreme is now commonplace, showing the strength and tenacity of Mexican criminal organizations. *Express Magazine*, a Washington Post publication, printed news of the war between the two main drug cartels in Mexico (Sinaloa and Zetas). The cartels went so far as to display fourteen headless bodies in front of City Hall at the border town of Nuevo Laredo. They also hanged nine people, four of them women, from a bridge in that same town. They left eighteen mutilated bodies in a van near Lake Chapala, and used a garbage truck to haul another 49 bodies (with no heads, hands or feet) near Monterey, Mexico’s most important industrial city. The magazine also covered the battle, considered

¹ In *Mafia & Co. The Criminal Networks in Mexico, Brazil, and Colombia*, p. 9.

² See *Considering New Strategies for Confronting Organized Crime in Mexico*, p. 9.

the most spectacular fought for intimidation and propaganda purposes, in front of TV cameras in May 2012, in which many headless bodies of innocent bystanders were publicly tossed about to terrorize civilians and frighten authority figures, such as President Felipe Calderon.³

With regard to the Italian mafia, Francesco Messineo observes how they get help from white-collar criminals: “They not only help the Mafia, but also commit crimes in their specific sector. This can be said of all crimes dealing with public bidding processes, even where the hand of the Mafia is not involved, although it generally is, or in such cases as corruption, collusion, and other well-known crimes against the public.”⁴

Important initiatives in the war on transnational organized crime also occurred in Brazil. In 2007, Colombian drug lord Juan Carlos Ramirez Abadia, also known as Chupeta, was arrested in São Paulo and sentenced, with several others, to more than 30 years in prison,⁵ and afterward extradited to the United States. Other important actions were taken against the First Command of the Capital (PCC), a powerful criminal organization involved in miscellaneous crimes such as robbery, extortion and drug trafficking in São Paulo. The police have stepped up their actions in the shantytowns of Rio de Janeiro.

Despite these initiatives, organized crime is still active and adapting itself to enforcement efforts—whether by moving to new territory (Rio de Janeiro) or spreading out its activities in the so-called baby cartels or micro organizations. It has kept up its strength through well-armed groups assuring its control over extensive regions and the manpower to respond to government enforcement efforts.

In June 2012, police cars were hit by gunfire on the east side of São Paulo. This occurred during a week in which a series of attacks on off-duty police officers culminated in the deaths of five agents, believed to be a reaction by the criminal gang “First Command of the Capital” (PCC) to an police operation elite squad that killed six people in late May.⁶

Organized crime has indeed defied all stability and government control, and not just in poor suburbs or rural areas. One example occurred in May 2006, when over 80 people were killed, 30 buses set on fire and a large number of private homes

³ Cf. Two Top Cartels at War in Mexico. *Express*. Washington, DC: a publication of the *The Washington Post*, p. 6, 05/25/2012.

⁴ In *Máfia e Crime de Colarinho Branco: a new approach to analysis. Novas tendências da criminalidade transnacional mafiosa*, p. 301.

⁵ Record No. 2007.61.81.0011245-7/SP, conviction in 2008 upheld by the Regional Federal Court for Region 3 (São Paulo and Mato Grosso do Sul), Criminal Appeal No. 0001234-26.2007.04.03.6181/SP, heard on 03/06/2012, Rapporteur, Federal High Court Justice Johansom di Salvo).

⁶ Cf. André Camarante. Carro da Polícia Civil é atingido por tiros na zona leste de SP. <http://www1.folha.uol.com.br/cotidiano/1109151-carro-da-policia-civil-e-atingido-por-tiros-na-zona-leste-de-sp.shtml>. Published 06/22/2012. Accessed Aug 2, 2012.

attacked because the government had announced the transfer of PCC leaders to maximum-security prisons.

This happened because one of the most effective instruments for crime fighting is to cut off its financing, that is, to confiscate the proceeds of drug sales and to cut off, limit or control the flow of money across borders.

Indeed, the movement of money between states through transportation of large sums in cash or electric transfers through bank accounts, added to the possibility of completely uncontrolled transportation of prepaid access cards or stored value instruments, or even black market moneychangers, invariably made up of persons who are well-connected—despite having violated laws against money laundering—must be stopped.

Money laundering can also occur through the mechanism of fraudulent payments—by, for example, fixing the price below the market value, or simply leaving out part of the amount payable. The price actually paid will surely be in cash or some untraceable means and delivered to the seller under the table. Then again, when prices are pegged at artificially high levels, the launderer may wish to have illicit financing of his acquisition and, to that end, will resort to bad appraisers and fake documentation.

Any time such facts or possibilities are known to authorities, all of them mindful that such crime is well-financed, no crime should go unpunished because that will surely lead to increased perpetration by others, and ultimately to the financing of terrorism.

There is much intelligence work to be done, more than that involved in simply controlling one's borders. Intelligence forces need to work together, because if they are kept apart, each may, in isolation, feel that someone else is responsible for the problem.

We must therefore approach the problem from a technical angle, for in many countries there is an atmosphere that fosters the adoption of solutions that are ineffective, scattered, poorly coordinated and not cohesive, especially owing to considerable social inequality.

It is not at all uncommon for officeholders to announce, before the elections, their wish to establish strategies for taking the money back out of crime, but little is actually done other than budget cuts to the detriment of public safety. Indeed, the perception has been that money laundering is a victimless crime, and for that reason it does not claim the attention of society, politicians and journalists.

6.1 Wire Transfers and Black Market Moneychangers

When people or companies seek to send or receive money from unlawful behavior across national borders, undetected by government institutions, they have come to rely more and more on transfers known as dollar wires or Euro wires, operated by agents known as dollar-changers (*doleiros*), whose activities stretch the legal envelope.

Along these lines, Terry Goddard informs us that the Arizona Financial Crimes Task Force searches for financial anomalies, disproportionate events unconnected with economic reality. “They immediately saw that Arizona was a huge net importer of wired funds. At the top ten Arizona wired-funds locations, over \$100 was coming in for every dollar wired out. Wire transfers into Arizona from other states, in amounts over \$500, totaled more than \$500 million per year. Since there was no apparent business reason for this imbalance, the investigators took a closer look.”⁷

For example, to preclude the use of fake identities for structuring or fragmentation of operations by companies and individuals in order to keep below the regulatory daily limit of \$10,000 that would justify reporting the operation to the authorities, the State of Arizona established Geographic Targeting Orders (GTOs) that require additional identification, such as fingerprints and signatures from all persons receiving wire transfers in excess of \$500. Based on such information, twenty-five warrants were issued between 2001 and 2006 for the seizure of wire transfers supposedly made in payment for human smuggling or narcotics trafficking.⁸

The Financial Action Task Force recommends that participating nations obtain detailed information on all parties to wire transfers, both senders and beneficiaries, for monitoring purposes. This would enable the barring of transactions by certain people in accordance with UN Security Council Resolutions 1269/1999 and 1373/2001 on the prevention of terrorism and its financing (Recommendation No. 16).

Brazil’s foreign-exchange legislation spells out a number of issues that are often unheard of, even in the United States.

Take, for example, Law No. 4131 of October 19, 1962,⁹ which requires contracts for currency exchange operations in its Section 7, included by Law No. 11371/2006:

Art. 23. Operations on the free exchange rate market shall be conducted through establishments licensed to conduct foreign-exchange operations, with the intervention of an official broker whenever the law or regulations so provide, both of entities being required to know the client’s identity, and how to correctly classify information provided by said client, pursuant to regulations established by Brazil’s Currency and Credit Authority.

(...)

§ 2 False statements of identity on the form which, in number of copies and following the model established by the Brazilian Central Bank shall be required in each operation to be signed by the client and checked and initialed by the banking establishment and broker therein intervening, shall render the banking establishment subject to charges for infraction, which carry a penalty of a fine in the amount of fifty percent (50%) to three hundred percent (300%) of the amount of the operation assessed against each of the violators. (New language given by Law No. 9069 of 1995)

(...)

⁷ Cf. *How to Fix a Broken Border: FOLLOW THE MONEY*, p. 3.

⁸ *Id.* p. 4.

⁹ In www.planalto.gov.br/ccivil_03/leis/L4131.htm. Accessed July 16, 2012.

§ 7 Completion of the form referenced in § 2 of this article is not required for foreign currency purchase and sale operations of up to three thousand dollars (US\$3,000) or its equivalent in other currency. (Included by Law No. 11371 of 2006)¹⁰

Because of Brazil's currency exchange regulations, remittance companies are required to conduct all of their operations exclusively through financial institutions duly licensed by Brazil's Central Bank, and this also holds for international banking institutions. They must have agreements on file with accredited banks to engage in exchange operations in Brazil, under penalties provided by several regulations—in particular, Law No. 9069 of June 29, 1995 (the *Lei do Plano Real*),¹¹ which established the *real* as Brazil's legal tender. It is the currency used to settle all transactions in Brazil.

Its Article 65 provides:

Art. 65. The entry into and departure from Brazil of domestic and foreign currency must be processed exclusively through bank transfers, where banking establishments are required to fully establish the identity of the customer or beneficiary.

§ 1 Excepted from the provisions contained in the heading of this article is the transportation, in cash, of the following amounts:

I – When in Brazilian currency, up to ten thousand reals (R\$10,000);

II – When in foreign currency, the equivalent of ten thousand reals (R\$10,000);

III – When it can be shown to have entered or left Brazil in accordance with pertinent regulations.

§ 2 The National Monetary Council shall, according to the guidelines from the President of the Republic, regulate the provisions of this article and also provide limitations and conditions for entry into and exit from Brazil of national currency.

§ 3 Failure to comply with the provisions of this article shall, in addition to sanctions provided in specific legislation and following due legal process, entail forfeiture to the National Treasury of all amounts in excess of those set forth in § 1 of this article.

Legislative Decree (Decreto-lei) No. 857 of September 11, 1969,¹² requires the use of national legal tender in all domestic operations, rendering null and void all operations stipulated in foreign currency or which would, in effect, restrict or refuse Brazilian currency as legal tender, but does list several exceptions to the ban.

In this regard, it provides:

Art. 1 – All contracts, securities and documents, and bonds callable in Brazil, which stipulate payment in gold, in foreign currency, or in any way serve to restrict or refuse the *cruzeiro* as legal tender, are null and void by law.

Art. 2 – The provisions of the preceding article do not apply to:

I – Contracts and paper relating to the importation and exportation of goods;

II – Contracts for financing or putting up bonds or guarantees relating to the exportation of nationally-produced goods, sold abroad on credit;

¹⁰ The fact that the Central Bank deals more simply with amounts of up to \$3,000, dispensing with the currency exchange agreement, in no way constitutes a waiver of the requirement that all debits and credits in customer accounts or through financial instruments be recorded so as to allow tracking of assets.

¹¹ See www.planalto.gov.br/ccivil_03/leis/L9069.htm. Accessed July 16, 2012.

¹² In www.planalto.gov.br/ccivil_03/Decreto-Lei/Del0857.htm. Accessed July 17, 2012.

III – Foreign-exchange purchase and sale agreements in general;

IV – Loans and any other obligations in which the creditor or debtor is a person residing and domiciled abroad, excepting only contracts for the lease or rental of real property within Brazilian territory;

V – Contracts for purposes of assignment, transfer, delegation, assumption or modification of obligations referenced in the preceding item, even if both parties to the agreement are residents of and domiciled in Brazil.

Sole Paragraph – Real property lease or rental agreements stipulating payment in foreign currency must, to be enforceable, and be registered in advance with the Brazilian Central Bank.

For its part, Decree No. 23258 of October 19, 1933,¹³ provides that the purchase and sale of foreign currency shall be made exclusively in institutions authorized by the Brazilian Central Bank to engage in currency exchange operations, and establishes that:

Art. 1. All foreign exchange operations conducted between banks, natural persons or legal persons domiciled or doing business in Brazil, with any entities abroad—whenever such operations are made other than through banks licensed to operate in foreign exchange through prior accreditation by examiners on behalf of the Brazilian Central Bank—are considered illegal exchange operations.

This set of codes (Law No. 4131/1962, Article 23; Law No. 9069/1995, Article 65, heading, and Legislative Decree No. 23258/1933, Article 1) makes foreign exchange agreements mandatory (or, for operations of up to US\$3,000, more simplified forms), thereby establishing Brazilian currency (the real) as legal tender while requiring identification of customers and declaring illegal all foreign exchange operations not conducted through banks accredited by the Central Bank.¹⁴

By the rules of Brazil's Financial Intelligence Unit (COAF), the item Cash Transfers covers remittances and only applies to the mail and Brazilian postal money orders, both domestic and international, since everything coming from abroad and involving currency exchange operations comes under Central Bank supervision.

There is an official market in the United States which often made use of gray market operators (currency brokers) to allow transfers of money belonging to uninformed foreigners residing in Brazil. To stock its operations, Brazilian currency (reals)—usually in cash (from illegal conduct in Brazil)—was deposited by the Currency Exchange into the accounts of beneficiaries of wire transfers coming from abroad, while the dollars or euros received from the senders (easy prey) are diverted to redeem and deposit money as part of this bartering in funds. This is the so-called wire operation.

One should bear in mind that whenever the number of immigrants in a given location increases, there is a proportional increase in the gray-market transfer of

¹³ In www.planalto.gov.br/ccivil_03/decreto/1930-1949/D23258.htm. Accessed July 17, 2012.

¹⁴ The International Capital and Foreign Exchange Market Regulations (RMCCI) consolidates Brazil's currency-exchange regulations. www.bcb.gov.br/?RMCCI. Accessed July 18, 2012. Resolution No. 3568 of 05/29/2008 is the primary regulation. <http://www.bcb.gov.br/pre/normativos/busca/normativo.asp?tipo=Res&ano=2008&numero=3568>. Accessed July 20, 2012.

money. Therefore, wherever there is an increase in illegal immigration,¹⁵ it is easier to commit financial crimes.

Another topic of concern is the entry of several factoring companies, which pump money into the accounts of wire transfer beneficiaries in the receiving country, thereby contributing to the offsetting of amounts in furtherance of an illegal black market in unauthorized financial dealings. Quite apart from their main purpose, which is short-term business financing of creditors' claims for goods and services provided on credit, the factor, or invoicer, is only required to keep a record of sales and perform administrative work relating to accounts receivable, receiving no sums and guarding against debtor insolvency.

According to the 1988 Convention on International Factoring held in Ottawa,¹⁶ a factoring contract is a contract between two parties, the client (supplier) and the factor, and the factoring company should perform at least two of the following functions: (1) provide financing for the supplier, including loans and advances on payments; (2) maintenance of accounts relating to the receivables; (3) collection of receivables; and (4) protect against default in payment by debtors. Nothing is said, therefore, about assisting remittance companies or currency brokers so as to obtain financial compensation on their balances.

Something similar to what occurs in the Black Market Peso Exchange, which has long served international drug traffic, also applies to Brazil, with the establishment of the black market in reals.

According to Resolution No. 13 of the Council for Financial Activities Control - COAF, factoring companies should report to them (COAF). The COAF intended important to make it possible to identify the owners and directors of factoring companies, perform due diligence on customers and check whether internal controls are in place. The aforementioned Resolution was revoked because the Central Bank not accredited factoring companies as financial institutions, and so never applied for licenses or registration.

Central Bank Circular No. 3542 of March 12, 2012, establishes in its Article 1, XI, a requirement to notify the Financial Intelligence Unit if, for instance: the customer does not provide justification for the origin of the money, or where the amount is incompatible with the customer's financial strength (item f); upon the realization of *resources from abroad*, there is financial incompatibility or absence of proper grounds (item g); or payments occur abroad after deposit of credit in reals into accounts held by persons named in the currency exchange operations, absent any business or financial links (item j). The U.S. Financial Crimes Enforcement Network (FinCEN) requires banks to perform due diligence on wire transfers to foreign agents or counterparties (31 CFR § 103).

¹⁵ For more on the influx of new immigrants who wire money back to their countries of origin, and their profiles, see *Briefing explores the factors that have influenced increases in remitting*. A publication of the Inter-American Dialogue, 03/20/2012, p. 1.

¹⁶ See <http://www.unidroit.org/english/conventions/1988factoring/main.htm>. Accessed July 10, 2012.

This is why irregular deposits show up in the accounts of recipients of wire transfers with no identification of the depositor, cash transfers to a beneficiary account from a company not authorized by the Central Bank to operate in the currency exchange market, or cash transfers to beneficiary accounts from individuals, for only financial institutions are eligible to receive Central Bank authorization to operate in currency exchange markets.

An occasional operation of this kind may be deemed acceptable if it has, in addition to an investigation as to the origin of funds, proof of deposit through a financial institution accredited by the Central Bank (such as a letter from the bank responsible for settling the operation).

Note that due diligence is not called for when the sending company has its home office in the United States (where that is the source of the dollars).

Cases have been observed of payments for drugs through the use of remittances from the United States in a triangle involving Colombia, the United States and Europe. Euros were brought in by mules (or smurfs) to Colombian currency exchanges, which shipped them to the United States, where they were packaged and sent to Europe, where the receiving company exchanged them for dollars that were then wired to the United States. These operations usually involve immigrants, and with the arrival of greater numbers of immigrants in any country, the number of transfers from one person to another increases annually.

6.2 Prepaid Access Cards, Stored Value Instruments and Bitcoins

Credit cards that allow access to an account through magnetic media and a password are quite common. However, there are prepayment vehicles that may be transferred and recharged, and quite possibly put to use by money launderers. Very low identification requirements on the part of financial institutions encourage such criminal practices. They do not themselves store value, but do provide access to an account.

It is difficult to distinguish between traditional credit cards and the network of prepaid access cards. Stored value cards should be clearly classified for the elucidation of government agencies and to facilitate identification of suspicious cards.

Such cards are usually not listed among monetary instruments, nor are they otherwise subject to customs declarations, although they often exceed the limit established for a Suspicious Activity Report. Authorities appear oblivious to the need to monitor these. These innocent cards or instruments can be worth millions, yet authorities are not concerned about them.

The cards closely resemble traditional credit cards, but provide access not to credit at a financial institution, rather to a sum of money stored on the card, on a chip, or simply in an account accessible using the card (which sometimes even

dispenses with the chip). Increasingly, particularly in the United States,¹⁷ payments are made by this means. There are many different kinds.

The least sophisticated are good for a fixed amount and are activated by a sales clerk. As purchases are made, those amounts are deducted from the card balance until it is exhausted. Such cards are not rechargeable. Typically referred to as gift cards, they are sold at checkouts in U.S. supermarkets. Such instruments make it possible, when they are carried in hundreds, to send millions of dollars.

Others may be reloaded using a computer or ATM. In these cases, they would represent small bank accounts and the balance does not even show up without proper software and hardware. Large sums can be stored, and easily passed from one person to another, making them absolutely anonymous.

These types of cards are often not subject to daily withdrawal limits, but only to the total stored value.

In both the United States and Brazil, no traveler is permitted to carry more than 10,000 dollars or reals in cash or cash equivalents (called monetary instruments, such as travelers checks, credit cards, negotiable bills of exchange, bearer checks or other documents convertible to cash) without declaring them to customs authorities. We should mention here that such stored value instruments are not classified, in either country, as monetary instruments for that purpose.

This legal loophole allows organized crime a great opportunity to circumvent controls on money laundering, especially across borders or simply through the mail.

The Financial Action Task Force establishes transparency requirements for beneficiaries of companies, with countries required to obtain reliable and timely information (Recommendation No. 24), including information on trusts, settlors, trustees and beneficiaries (Recommendation No. 25). Financial Intelligence Units (FIUs) must have timely access to financial and administrative information, either directly or indirectly, as well as information from law enforcement authorities in order to fully perform their functions, including analysis of suspicious statements on operations (Recommendations Nos. 26, 27, 29 and 31).

It recommends restricting or banning the physical transportation of currency (Recommendation No. 32), but says nothing about the cards and forms of payment mentioned here.

Bitcoins are digital money issued and transmitted over the Bitcoin Network, a network among friends that allows payment by any party to another. These transactions are connected to the Internet, and therefore communicate with other equipment, picking up or transferring signals from different regions. The signals are recorded in a public history listing (called a block chain) once they are validated by the system.

The Bitcoin network began on January 3, 2009, with the issuance of the first bitcoins by Satoshi Nakamoto. Owners transfer bitcoins by sending them to another Bitcoin address using a client program or website for the purpose. The

¹⁷ From a volume of just \$6.2 million ten years ago, the use of prepaid cards has skyrocketed to over \$800 billion in 2008, and is projected to increase to \$1.3 trillion in 2009 (according to Terry Goddard, in *How to Fix a Broken Border: FOLLOW THE MONEY*, p. 9).

transfer is accomplished by digital signature and connected to the public encryption key of the next owner. Bitcoin records all data necessary to make the transaction valid in the block chain.

A Bitcoin customer uses a wallet of Bitcoin addresses, and is free to create any number of Bitcoin addresses. Hence, if user “A” wishes to transfer bitcoins to user “B,” he will create a transaction message with instructions to send part of his balance to “B,” and the transaction will be validated by “A” by using a wallet key. Because of its asymmetric cryptographic method, only owners of a private key can create a valid signature to enable bitcoins to be sent from their wallets.

Using Bitcoins Exchange Services, one can buy or sell gift cards and exchange them for bitcoins.¹⁸

That amounts to the creation of a virtual database for issuing electronic money, in which users may check the coins once they are issued. So instead of withdrawing an amount in bills from a bank, a financial institution could be asked to coin (renew) a block of records identified by a hash value, which can be used for identification and integrity verification, and occasional returns to the bank.

This currency, according to Alaric Snell-Pym, runs into two difficulties. The coins are traceable using their unique serial numbers (much handier than the series of numbers printed on bills) and it is not easy to spot someone using the same coin twice since, consisting as they do of numbers, one could make as many copies as he wished. A number of systems have developed cryptographic techniques to prevent such duplication, complicating the transfer of funds to the point of making it difficult to ensure security.¹⁹

Problems surface once you notice that it is possible to use different addresses, with one of them used only once for a single transfer. Someone knowledgeable could create new addresses and transfer monetary amounts to a number of other addresses through several identities or pseudonyms, unless there were some tracking of Internet records to analyze the transaction from a global perspective. By checking network connections over the World Wide Web, one could verify spending on transactions and know to which addresses they were directed.

Bitcoins can be as anonymous as cash, so there has to be some method or means of breaking that anonymity and tracking the flow of money. There must be some form of electronic tracking, even easier than for cash money, which simply passes from hand to hand. Bitcoins are a transparent means of transacting compared to the existing system. But even though it features the use of fake names or nicknames, identifying its users does not seem all that impossible. Hence, if a trafficker is using a given Bitcoin address, you can download all data on the person using that address and download the entire graph of parties with whom that

¹⁸ See, for example, <http://www.bitcoinexchange.cc/aboutcompany.html>. Accessed May 25, 2012.

¹⁹ In *Bitcoin Security*. <http://www.snell-pym.org.uk/archives/2011/05/12/bitcoin-security/>. Accessed Mar 8, 2012.

trafficker has dealings, and it might be possible to obtain information on his entire clientele. Therefore, this medium may not be as anonymous as it appears at first.

Still, one can easily imagine, as mentioned by Jon Matonis,²⁰ someone creating an anonymous bitcoin structure with many branches in order to hide his transactions.

The mere fact that it is electronically traceable does not preclude its being successfully used for illegal ends. As more of these types of services become available online, the transactions become more complex and there is greater opportunity for apparently unrelated, off-the-grid value exchanges.

6.3 Using NGOs, Trusts, Associations and Foundations for Illegal Ends

Just as the work of beneficent entities has been important, scandals have stained some of their images and opened the door to an increase in judicial actions against their directors, increasing skepticism in proportion to news coverage of events.

Because their work is philanthropic, and they are generally motivated by altruism and compassion, charities have been immune to legal proceedings. They may be made answerable on account of internal management issues or even external problems (everything from labor suits to fraud, and even money laundering by reason of insolvency, negligence or poor practices). Its entire board of directors might be held liable for some failure of accounting or diversion of funds.

Nongovernmental organizations, trusts, associations and foundations tend to be as diverse as a country's population. People are increasingly becoming involved in social or charity efforts and donations to these social entities have been large.

Recent disclosures have tarnished the images of certain entities and brought the glare of publicity onto the conduct of some of their managers. A backlash of skepticism has brought about a proportional reaction affecting the volume of donations and volunteer work.

Because philanthropic work is normally motivated by generosity and empathy, charitable organizations often imagine themselves immune to legal proceedings. Liability could surface based on some poorly-handled internal activity, or some other cause occurring outside the organization, which is why the role of the manager is so important.

Since they operate from personal and institutional donations, charity organizations (often synagogues, churches, mosques, NGOs, educational associations, etc.) believe that they are not required to reveal the sources of their funds, nor to be examined for the large financial transactions they conduct.

The U.S. Congress has, since 1917, allowed deduction of donations to charitable, religious, educational and other such entities organized as nonprofit NGOs.

²⁰ In *The Monetary Future at the Intersection of Free Banking, Cryptography, and Digital Currency*. Thoughts on Bitcoin Laundering. Published May 13, 2011, <http://themonetaryfuture.blogspot.com/2011/05/thoughts-on-bitcoin-laundering.html>. Accessed Mar 8, 2012.

We cite a 1938 report from the House Committee on Ways and Means in which Erin Thompson explains that tax revenue losses due to charitable donations are offset by easing the financial burden, which, through the resulting benefits, promotes the general welfare.²¹

According to Andrew Cuomo, philanthropic organizations “contribute substantially to our society. They educate our children, care for the sick, preserve our literature, art and music for us and for future generations, house the homeless, protect the environment and much more.”²²

The correctness of granting large tax deductions has been the subject of frequent assessment of its effectiveness, purpose and potential for abuse. All of this has, according to the author, brought about changes in the law: statutes and regulations governing charitable deductions.

Thus, a philanthropic transfer in the United States must satisfy a complex set of rules to qualify as a tax deduction. These rules are grouped, according to the author cited,²³ into three main requirements: the transfer must be sent to a qualified addressee²⁴; it must clearly state the purpose of the donation, that is, not be an exchange of goods or services²⁵; and it must consist of a payment or other allowable goods.²⁶

The third requirement brings us back to the question of payments.

In the State of New York, for example, in order to set up a foundation or NGO,²⁷ a license must be obtained to qualify for tax exemption, and returns must be filed to the State tax authorities, under penalty of being closed down, by means of Form No. 990, dated and properly signed on penalty of perjury, and containing the name and telephone number of the person who keeps books and records for the organization.

The form must be filled out to include a detailed list of all of its activities and management, its revenues, overhead and liquid assets. It must state the name and purpose of the institution; number of members; whether it has more than 25% of its liquid assets on hand; number of voting members listed within or outside the entity; number of employees; number of volunteers; revenues from unrelated businesses and taxes paid; contributions and donations; resources invested; benefits paid by and for members; total assets and obligations; basic description of all assistance programs; whether any loans or benefits are granted to or for employees,

²¹ In *The Relationship between Tax Deductions and the Market for Unprovenanced Antiquities*. 33 Colum. J.L. & Arts 241, 2010.

²² Cf. Internal Controls and Financial Accountability for Not-for-Profit Boards. *Charities Bureau*. In <http://www.oag.state.ny/bureaus/charities/about.html>. Accessed June 20, 2012. p. 01.

²³ *Id.* p. 242.

²⁴ Cf. I.R.C. § 170 (c) (2006).

²⁵ See *McLeman v. United States* (24 Cl. Ct. 109, 91-2 USTC 50, 447, 1991).

²⁶ In I.R.C. § 170 (e) (3) (2006).

²⁷ Provided they are also recognized as such in the U.S. tax code, also known as the Internal Revenue Code, Section 501 (c); 527; 4947 (a) (1).

directors, trustees or any other persons; the names, hours worked, and job descriptions of all employees and former employees (including directors, trustees and key personnel); their earnings, and their expenses (including travel or leisure).

For gross revenues of up to \$100,000, no external audits are required. From \$100,000–\$250,000, the information must be entered by an outside auditor (and documentation reviewed by that professional), who does not, however, check the veracity of information obtained. In other words, it is not the auditor’s job to check donor transactions (to conduct the due diligence). But NGOs with gross annual revenues in excess of \$250,000 are required to turn in an outside auditor’s report, and that auditor must perform the due diligence.²⁸

The Foundation Center, a U.S. center for information on foundations, has published some 29 standards; Brazil, meanwhile, has six of them, all unpublished (a veritable case of living in a glass house).²⁹

Management and employees of nongovernmental organizations must be answerable for their management and for the protection of the goods and services that benefit us all.

A primary responsibility is to ensure proper accounting for the social programs that they play a role in, and for funding received from their supporters (public or otherwise). This means that they must strictly comply with the law and ethical standards, be committed to the mission of the NGO they represent, protect the rights of their members and, indirectly, of those assisted, and prepare annual reports for their country’s federal revenue service and regulatory authorities having jurisdiction—reports that should be available to all interested parties.

They should therefore have technical information at their fingertips to enable them to monitor and record all assets and amounts received, spent or entrusted to their care.

The website of the National Association of State Charity Officials (NASCO)³⁰ contains important information on the recording and reporting required of NGOs. NASCO members are employees of U.S. government agencies charged with regulating NGOs and their funds.

Marion R. Fremont-Smith, who teaches Public Policy at the John F. Kennedy School of Government, produced an important comparison for Harvard University on the bookkeeping requirements for such organizations. She showed, for instance, that most U.S. states (for example, New York, California, Arkansas, Missouri, and New Jersey) require that they have at least three directors.³¹

²⁸ Cf. www.charitiesnys.com or www.charitiesnys.com/pdfs/statute_booklet.pdf. Accessed May 29, 2012.

²⁹ According to information provided by Patricia Lobaccaro on 05/16/2012. Ms. Lobaccaro is president and CEO of BrazilFoundation, with offices at 345 7th Ave., Suite 1401, New York City.

³⁰ www.nasconet.org. Accessed June 2, 2012.

³¹ In *The Search for Greater Accountability of Nonprofit Organizations. Summary Charts: State Nonprofit Corporation Act Requirements and Audit Requirements for Charitable Organizations* (document obtained 05/16/2012 from Patricia Lobaccaro, president and CEO of the BrazilFoundation).

FATF Recommendation No. 08, in the spirit of clearly delimiting the rights and responsibilities of directors and employees of nongovernmental organizations, encourages countries to establish a good policy whereby information on their activities, size and other important characteristics—such as transparency, integrity, openness and best practices—can be had in real time for purposes of supervision and monitoring.

It is not enough to only dimly perceive here a preoccupation with the financing of terrorism, for they could be the means of commission of any number of crimes—including terror-related crimes.

In Pakistan, for example, the Central Bank has placed much stricter controls on NGOs and benevolent societies, ordering a complete review of all their accounting before the end of 2012, under threat of making them subject to penalties. The purpose was to establish a policy and a set of rules for compliance (to strengthen due diligence) and to protect them from the risk of money laundering and terrorism financing. All of the country's financial institutions are being required to open accounts in the name of NGOs that match the documents submitted to them. In the event of an organization publicly soliciting donations or the like, accompanied by a bank account number, those financial institutions must promptly take note of and report that account if the account owner of record does not match that of the publication.³²

Two government intelligence cells were created in India to detect sources of funding used to finance terrorist activity. Analysts there believe that terrorist attacks in India are funded by neighboring countries through NGOs and nonprofits. Up until now they had no way of checking on how funds from abroad, purportedly intended for health and education, would actually be used.³³ In 2010 there were some two million NGOs there, but of that number, only 71 had requested any reimbursement for taxes paid. In 2009 there were 38,600 registered with the government to receive donations from abroad. Some are suspected of being money laundering channels for the return of illegal cash received from Indian politicians or for terrorism financing, much of it qualifying as investments coming through Mauritius.³⁴

NGOs, associations and foundations lacking proper controls are recognized today as channels for money laundering for organized crime. In fact, the Financial Action Task Force (FATF) has found that sums transferred from NGOs abroad have provided funding for the financing of terrorism on a par with counterfeiting,

³² Cf. Terror outfit-turned 'charity' JuD set to come under Pak Central Bank scanner. In *Asian News International*, 03/13/2012. www.lexis.com. Accessed June 19, 2012.

³³ In Prafulla Marpakwar. State forms cells to detect source of terror funds. *Times of India*. www.westlaw.com. Accessed June 19, 2012.

³⁴ For more on this, see John Samuel Raja, in Ten means to put an end to black money issue. *Economic Times (India)*. Copyright 2011 Bennett, Coleman & Co., Ltd., *The Financial Times Limited*. 11/18/2011.

drug trafficking, extortion and corruption. This has prompted India, for example, to assemble an umbrella database listing them all.³⁵

Money laundering is usually carried out using a layered structure to give the appearance of legality. One such method is to establish trust companies through which the company manages business for its clients, the beneficiary being one or more holding companies, or a series of companies in several tax havens, to create a separation between the aforesaid holding companies and their ultimate beneficiary. Moreover, the discovery of the real beneficiary would require considerable cooperation on the part of authorities in those tax havens. Some means would have to be established to require the trust to provide its beneficiaries' names whenever requested by the authorities.

It is not even easy to establish who is in charge of the trust since there is no obligation that the name be revealed. Hence, being its legal beneficiary is an enviable business—which may explain the rather timid recovery of illegal assets.

There are efforts under way in India to publicize the names of organizations (religious NGOs or trusts) requesting tax exemptions. One of India's wealthiest trusts collects huge sums of cash. At the time of this writing, there are a number of laws and several states seeking to monitor the activities of these entities. Yet Parul Soni (of Ernst & Young Pvt. Ltd.) believes that federal legislation will be required to achieve bookkeeping transparency and to strengthen the reporting of suspicious activity in that sector.³⁶

Trusts, although they may be synagogues, churches or mosques, nongovernmental organizations, or educational institutions registered as NGOs, must now reveal the sources of their funds and have their financial transactions closely scrutinized. This is because of new jurisprudence requirements under India's Prevention of Money Laundering Act of 2002.

Indian attorney Bhusham Bahal tells us that the laundering of illegal money has been largely made possible by NGOs operated by powerful businessmen and top politicians, so that this new instrument should prove to be of valuable assistance to the authorities.³⁷

Pakistan has also adopted strict measures to curb money laundering and financing of terrorism by NGOs by putting in place a very broad know-your-customer policy. It requires photocopies of customer photo IDs (identification card or passport), and a copy of the assignment, if done through power of attorney. Companies

³⁵ Cf. Most recent FATF report in www.gafi-fatf.org, 06/22/2012; Government plans 'umbrella law' to tighten scrutiny and regulation of religious trusts and NGOs. *Economic Times* (India). Copyright 2011. Bennett, Coleman & Co. Ltd. 05/03/2011. www.westlaw.com. Accessed June 22, 2012.

³⁶ Cf. Government plans 'umbrella law' to tighten scrutiny and regulation of religious trusts and NGOs. *Economic Times* (India). Copyright 2011. Bennett, Coleman & Co. Ltd. 05/03/2011. www.westlaw.com. Accessed June 22, 2012.

³⁷ See Palak Shah. Trusts, NGOs under ambit of money-laundering law. *Business Recorder*. Recorder Report, 09/12/2009. WLNR 17872644. www.westlaw.com. Accessed June 23, 2012.

must produce their charter and by-laws, and a list of directors. Similar documentation is required of individuals, along with audit documents required of clubs, associations or nonprofit associations.³⁸

The trump card in the Indian case is the requirement that sources of funds be revealed, so that know-your-customer policies have to be in place for donations to be received by the NGOs, as is already the case for financial institutions. They must also provide detailed information on investments and donations received, and anonymous donations are henceforth barred.³⁹

In Canada, nongovernmental organizations are as diverse as the population. Many Canadians are involved in charity work, with estimates running to some 36% of the population. Economically, the sector is a major player, inasmuch as two million people are employed within it, with another two billion hours voluntarily contributed. There are over 160,000 NGOs operating nationwide and 85% of the population makes financial contributions to Canadian social entities.⁴⁰

Considerable customer due diligence is required. The donor's name or job title is no longer enough (photo ID is preferred). For instance, the donor's purposes and actual financial position must be known (preferably face-to-face), along with his signature or the signatures of those acting on his behalf. The source of funding must also be disclosed, and supported by documentation. In the case of a donor company, a copy of the by-laws is required (in order to check the list of directors) from the civil or deed registry having jurisdiction. The actual directors of the NGO must be known, again with photo ID, along with the scope of their authority, all backed by documentation to properly support the information provided.

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³⁸ Cf. Money Laundering, terror financing: SECP imposes more conditions. *Business Recorder. Recorder Report*, 09/12/2009. WLNR 17872644. www.westlaw.com. Accessed June 23, 2012.

³⁹ Again, Palak Shah (Trusts, NGOs under ambit of money-laundering law. *Business Recorder. Recorder Report*, 09/12/2009. WLNR 17872644. www.westlaw.com. Accessed June 23, 2012.).

⁴⁰ For more on this, see Rob Bickerton (in Good Cause. *Canadian Underwriter*. 01/25/2010. 2009 WLNR 26429376. www.westlaw.com. Accessed June 23, 2012).

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