SANDLER REIFF

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MEMORANDUM FOR SANDLER REIFF CLIENTS

Re: H.R. 9495 – Stop Terror-Financing and Tax Penalties on American Hostages Act
Date: November 25, 2024

Last week, the U.S. House of Representatives passed H.R. 9495, a controversial bill that would give the Internal Revenue Service the power to suspend the tax-exempt status of any U.S. 501(c) nonprofit organization determined to be a "terrorism supporting organization " ("TSO") through a designation procedure set out in the bill. It currently appears likely that the bill will be approved by the Senate, if not in the lame duck session next month, then next year. This designation would only potentially apply to 501(c) organizations, and not to candidates, PACs, or party committees.

The bill's proponents have made clear that the primary targets of this provision are pro-Palestinian U.S. organizations alleged to be linked to or working closely with long-designated foreign terrorist groups such as Hamas. However, the new law, if enacted could potentially affect a range of other nonprofits as explained below. In particular, the law would put at risk the tax-exempt status of groups merely advocating certain positions aligned with those of a foreign terrorist organization ("FTO"), ***if it's alleged that they communicated or coordinated with that FTO*** as well as groups providing various forms of humanitarian aid in Gaza and other regions in which foreign terrorist groups operate.

Also, because of the way the law is structured, a US nonprofit providing advice or assistance to any U.S. group designated as a "terrorist supporting organization" could then itself be designated as a "terrorist supporting organization."

There is a process for "cure" before a TSO designation is finalized, and a final designation as a TSO could then be challenged in an action brought in U.S. District Court, as discussed below.

In practice, given the potential breadth of the bill and the legal and political consequences of potentially being designated a TSO , we recommend that:

I. Groups review their direct connections to ***foreign*** organizations to evaluate whether those groups *could* be designated as engaging in terrorism by a hostile administration; and

II. Groups review their connections to ***domestic*** organizations *that coordinate with* ***foreign*** *organizations* that *could* be designated as engaging in terrorism by a hostile administration.

We will continue to provide updates as the bill makes its way through the legislative process and if it is enacted. In the meantime, if you have any questions about the bill please contact us.

1. Which Groups Could be Impacted?

As noted, the bill's proponents have made clear that it is targeted at U.S. nonprofits that have worked with or provided assistance to a "foreign terrorist organization" ("FTO"). An example cited by Republican Members during the House debate is the Alliance for Global Justice, an Arizona-based (c)(3) alleged to have engaged in fundraising for the Popular Front for the Liberation of Palestine, a designated FTO.

However, the bill *could* subject a range of other groups to potential designation as a TSO and suspension of tax-exempt status:

a. Advocacy Groups

Groups advocating pro-Palestinian or other positions critical of Israel risk designation as a TSO ***based on allegations that they have communicated or coordinated in some way with an FTO*** – even just as to the advocacy activity itself. As discussed below, the courts have held that "material support" can include mere advocacy ***if it is coordinated with an FTO***.

b. Humanitarian Work

U.S. groups providing assistance or personnel for humanitarian purposes in regions in which FTO's are operating could be designated as TSO's. There is a narrow exception in the statute defining "material support," for provision of medicine but no exception for other forms of support such as professionals or volunteers working in hospitals, advocacy for political prisoners and the like.

c. Chain Designation

One of the lesser known but troubling features of the bill is that it provides for designation as a TSO of a U.S. nonprofit that provides "material support or resources" to another U.S. group that has already been designated a TSO.

For example, if a U.S. pro-Palestinian group is designated as a TSO under the new law, the IRS could then turn to a U.S. civil rights/civil liberties or legal services group that had provided legal representation or assistance, all in the U.S., to the former group – and designate that civil rights/civil liberties or legal services group itself as a TSO.

d. Designation of Additional FTO's

It is also possible that the Trump State Department could designate as FTO's new foreign organizations that engage in civil disobedience, in foreign countries, in support of environmental or other causes. A U.S. group providing assistance to that foreign organization could then be designated as a TSO.

The bar for designation as an FTO is relatively high but it is difficult to say at this point whether the Trump Administration could or would find ways to add new foreign groups to the FTO list.

2. What is a "Terrorism Supporting Organization" covered by the new law?

The State Department, on consultation with Treasury and the Attorney General, designates a foreign organization as a "foreign terrorist organization" ("FTO") if it meets certain criteria, and subject to limited congressional review. There is a process for initial limited judicial review and then limited administrative review after two years. The current list of designated "foreign terrorist organizations" can be found on the State Department website. The list includes such groups as ISIS, Hamas, Islamic State, Al Qaeda, Popular Front for the Liberation of Palestine, and numerous others.

Under current law, if an organization designated as a FTO or an organization made subject to U.S. sanctions because of terrorist activity, has a tax exempt status under section 501(c), that tax exempt status is automatically suspended as soon as the organization is designated as an FTO or made subject to sanctions.[1] The suspension continues as long as the organization is designated as an FTO or is subject to sanctions.

What the new law would do is add a provision empowering the IRS to suspend the tax exempt status of any U.S. 501(c) organization designated by the IRS as a "***terrorist supporting organization***." That power could be exercised against any 501(c) organization – including both 501(c)(3)'s and (c)(4)'s – though not against political organizations (exempt under section 527 of the Internal Revenue Code, such as PACs).

The new law defines "***terrorist supporting organization***" as "any organization which is designated by the [IRS] as having provided, during the 3-year period ending on the date of such designation, material support or resources (within the meaning of [18 USC 2339B, a provision of the federal criminal code]) to [an FTO or group subject to U.S. sanctions because of terrorism] in excess of a de minimis amount."

[1] Internal Revenue Code section 501(p)(2)-(3))

a. Basis for IRS Designation

Under the bill, the IRS designation of a TSO requires a finding by the IRS that:

i. The U.S. 501(c) organization provided "material support or resources" to an FTO;

ii. Sometime in the three-year period preceding the designation.

The term "material support or resources" is as defined under the statute making it a serious federal felony – subject to up to life imprisonment – for anyone to provide "material support or resources" to an FTO, or to attempt or conspire to do so.[2] That criminal statute requires that the provision of, or attempt or conspiracy to provide, material support or resources to a FTO be done ***knowingly*** to invoke liability. In other words, the government must show that:

i. The defendant knew that it was providing something to an entity; and

ii. The defendant knew that the entity is a FTO or has engaged in terrorism or terrorist activity.[3]

It is not clear whether the new law requires the IRS to make these findings, or indeed any finding of criminal intent, in order to designate a U.S. tax-exempt group as a TSO. Further, under existing law, this knowledge requirement does not in any event require intent to provide material support to the *terrorism specific activities* of the FTO. The Supreme Court has held that even "[m]aterial support meant to promote peaceable, lawful conduct" qualifies under the § 2339B definition, and that there is no distinction between the charitable, social, or political aspects of a designated organization that may effectively limit the application of the "material support" definition.[4]

The bottom line is that under the bill, the IRS does not need to have evidence sufficient to bring a case under the criminal statute in order to designate a U.S. tax-exempt group as a TSO. Under the bill, the IRS is not required to make any specific findings to issue the designation, other than, presumably, the finding that "material support or resources" were provided to an FTO during the three-year period.

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[2] 18 U.S.C. §2339B.

[3] *United States v. Wright*, 937 F.3d 8, 23 (1st Cir. 2019) ("[T]o prove a violation of [§ 2339B], the government must establish that a defendant (1) knowingly provided or attempted or conspired to provide material support . . . (3) that the defendant knew had been designated a foreign terrorist organization or had engaged in terrorism." (first and second alterations in original) (emphasis added) (quoting *United States v. Dhirane*, 896 F.3d 295, 303 (4th Cir. 2018)); *United States v. Al Kassar*, 600 F.3d 108, 129 (2nd Cir. 2011)(noting "two express scienter requirements: that the aid be intentional and that the defendant know the organization he is aiding is a terrorist organization or engages in acts of terrorism"); *see also United States v. Omar*, 786 F.3d 1104, 1112–13 (8th Cir. 2015); *United States v. Mehanna*, 735 F.3d 32, 42 (1st Cir. 2013).

[4] *Holder*, 561 U.S. at 30-31; *Agency for Int'l Dev. v Alliance for Open Soc'y Int'l, Inc.*, 570 U.S. 205, 220 (2013) (referencing *Holder* as applying "material support" to nonviolent operations of designated terrorist organizations.).

b. What is "Material Support or Resources"?

Under the criminal statute, "material support or resources" is defined as "any property, tangible or intangible, or service, including currency or monetary instruments or financial securities, financial services, lodging, training, expert advice or assistance, safehouses, false documentation or identification, communications equipment, facilities, weapons, lethal substances, explosives, personnel, and transportation, except medicine or religious materials."[5]

"Training" is defined as "instruction or teaching designed to impart a specific skill, as opposed to general knowledge."[6] "Expert advice" or assistance" means "advice or assistance derived from scientific, technical or other specialized knowledge."[7]

To be considered "personnel" covered by the definition, the person must have "knowingly provided, attempted to provide, or conspired to provide a foreign terrorist organization with 1 or more individuals (who may be or include himself) to work under that terrorist organization's direction or control or to organize, manage, supervise, or otherwise direct the operation of that organization."[8] However, "[i]ndividuals who act entirely independently of the foreign terrorist organization to advance its goals or objectives shall not be considered to be working under the foreign terrorist organization's direction and control."

Upholding the statute, the Supreme Court ruled in *Holder v. Humanitarian Law Project* that:

- The Government may prohibit material support to FTOs in the form of speech[9], ***but it must be coordinated with or under the direction of the FTO.***[10] Independent advocacy promoting the FTO or advocating for its goals, is not covered. But there is little judicial precedent providing any guidance for what coordination and independence mean in this context.

[5] 18 U.S.C. § 2339B(g)(4) (incorporating § 2339A(b)(1)). Noting also that the Court in *Holder* points to the dictionary definitions for the meaning of words in this section. 561 U.S. at 23–24 ("'[S]ervice' similarly refers to concerted activity, not independent advocacy. See Webster's Third New International Dictionary 2075 (1993) (defining 'service' . . . .)").

[6] 18 U.S.C. § 2339A(b)(2).

[7] 18 U.S.C. § 2339A(b)(3).

[8] 18 U.S.C. § 2339B(h).

[9] *Holder*, 561 U.S. at 28.

[10] *Holder*, 561 U.S. at 32-33.

- Material support to nonviolent operations of a FTO cannot be segregated from its violent operations.[11] Humanitarian activities, other than medicine and religious activities, are purposefully not exempted from the definition.[12]

- Among the prohibited forms of material support are training FTOs on "how to use humanitarian and international law to peacefully resolve disputes" and how to navigate various representative bodies, such as the United Nations and possibly U.S. courts.[13]

3. Process for Designation as "Terrorist Supporting Organization"

Under the bill, prior to designating a tax-exempt group as a TSO, the IRS would be required to mail a notice to the group that sets out:

a. The name of the organization(s) that the Treasury Department has determined to be FTO(s) or TSO(s) to which the nonprofit group provided material support;

b. A description of the material support or resources provided by the nonprofit group. However, the description may be brief and limited to "the extent that national security and law enforcement interests permit"; and

c. A statement of the IRS's intent to designate the nonprofit group as a terrorist supporting organization unless the group, within 90-days of the notice:

   i. Demonstrates "to the satisfaction of" the IRS that the nonprofit group did not provide the alleged material support or resources; or

   ii. The nonprofit group made reasonable efforts to have the support or resources returned to the group, and certified in writing to the IRS that the group will not provide any further support or resources to the indicated terrorist organization.

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[11] *Holder*, 561 U.S. at 29 ("[F]oreign organizations that engage in terrorist activity are so tainted by their criminal conduct that *any contribution to such an organization* facilitates that conduct.") (alteration and emphasis in original);

[12] *Holder*, 561 U.S. at 29-30 ("Congress…removed an exception that had existed [in the 1994 version of the statute] for the provision of material support in the form of 'humanitarian assistance to persons not directly involved in' terrorist activity. That repeal demonstrates that Congress considered and rejected the view that ostensibly peaceful aid would have no harmful effects. We are convinced that Congress was justified in rejecting that view." … "Material support meant to 'promote peaceable, lawful conduct, can further terrorism by foreign groups.")(citations omitted).

[13] *Holder*, 561 U.S. at 37; *see also id*. at 50 (Breyer, J., dissenting)(arguing that the majority supports a view that would "prohibit[] a lawyer hired by a designated group from filing on behalf of that group an *amicus* brief before the United Nations or even before [the Supreme] Court").

If a targeted nonprofit group is unsuccessful in its attempt to rebut or cure the designation, its status would be indefinitely suspended.

The organization could then appeal the designation in one of two ways:

i. initiate administrative review by the IRS Independent Office of Appeals; or

ii. challenge the designation in a U.S. District Court.

The bill makes clear that a group designated as a TSO can obtain judicial review in a U.S. District Court without first using the administrative process. But there are several factors that could inhibit the effectiveness of this channel for judicial review:

a. It is unclear whether a designated TSO could obtain injunctive relief in a U.S. District Court action, but it seems unlikely. In general, a party challenging denial or revocation of tax-exempt status is barred from seeking injunctive relief under the Tax Anti-Injunction Act.[14]

    i. It is not clear whether a designated TSO could nevertheless seek injunctive relief against a completely baseless designation either under the narrow exception created by the Supreme Court[15] or whether the provision in the bill providing for judicial review would somehow affect application of the Tax Anti-Injunction Act.

b. The law leaves unclear who would bear the burden of proof in a U.S. District Court action, but it presumably would be the designated group (as the taxpayer bears the burden in refund cases in which U.S. District Courts have jurisdiction).

c. That burden could be complicated by the fact that a designation could be based on classified information that could not be shared with the designated group, and which the new law specifically provides can be considered by the court without being disclosed to the designated TSO.

d. While the organization seeks review of the Treasury Secretary's designation, the organization would remain designated as a TSO and its tax-exempt status would remain suspended.

[14] Internal Revenue Code § 7421(a).

[15] *Enochs v. Williams Packing & Navigation Co*., 370 U.S. 1, 6-8 (1962)