

Senate Finance Committee Considers Major Charity Legislation

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In the previous issue of *The Nonprofit Advantage*, I discussed the effect of the Sarbanes-Oxley legislation on nonprofits. To refresh your memory: Sarbanes was enacted in response to corporate abuses in the commercial sector. Except for provisions concerning whistle-blower protection and document retention, Sarbanes does not directly apply to nonprofits. However, it is clear that the nonprofit sector is under pressure to adopt governance and accountability reforms, so the indirect effect of Sarbanes on nonprofits is to raise the bar on what are considered "best practices."

But the last paragraph of the article admonished readers to stay tuned because events were unfolding in Washington that could change the legal environment for the sector. This article will discuss that activity and how the nonprofit sector is responding to it.

In June 2004, the U. S. Senate Finance Committee, chaired by the very visible Senator Charles E. Grassley of Iowa, held a hearing on "Charity Oversight and Reform: Keeping Bad Things From Happening To Good Charities." The Senator is no stranger to nonprofit controversies, having previously conducted investigations into such organizations as United Way, Red Cross and The Nature Conservancy. His opening statement includes the following passage:

"Today the Finance Committee considers a very serious matter - ensuring that charities keep their trust with the American people. We will hear testimony today that is troubling. The testimony we will hear will suggest that far too many charities have broken the understood covenant between the taxpayers and nonprofits - that charities are to benefit the public good, not fill the pockets of private individuals. Too many well-meaning charities have fallen prey to the charlatans' pitch about easy money. Some charities are blinded by their own mission and the need for additional dollars. These charities are willing to sign onto deals that provide dollars to promoters and insiders but only pennies to the charity. It is the taxpayers who are the losers.

In addition to well-meaning charities being led astray, we also have a growing number of individuals who knowingly set up a charity to evade taxes. Finally, we have charities - even big-name [sic] charities - that seem to just have the wheels fall off. Often problems at these charities can be traced back to poor governance or failure to abide to best practices."

The Committee staff produced a white paper containing many far-reaching proposals for legislation. It is safe to say that the breadth and potential impact of the proposals are greater than anything seen since Congress considered the recommen-

dations that emerged from the Filer Commission (Commission on Private Philanthropy and Public Needs) more than twenty-five years ago. If enacted into law as proposed, the effect on public charities will be similar to the effect of the 1969 Tax Reform Act on private foundations.

Here is a sample of what the Senate Finance Committee is considering.

1. Five-Year Review of Exempt Status. Every exempt organization will be required to submit information to the IRS every five years to enable the IRS to determine whether the organization deserves to remain tax-exempt. The submission will include "current articles of incorporation and by-laws, conflicts of interest policies, evidence of accreditation [see below for an explanation], management policies regarding best practices, a detailed narrative about the organization's practices, and financial statements. Such information would be made publicly available."

2. Abolishing supporting organizations. Sometimes called Type III organizations, they include "friends of" organizations that raise funds for related charities, such as museums and arts groups.

3. Extend the private foundation self-dealing rules to public charities. Current federal law imposes a tax on a transaction between a private foundation and a person with substantial influence over the foundation. The tax will be extended to transactions between a public charity and a director, officer, key employee, founder, or any business over which any of those persons has a significant influence. Typical transactions could include purchasing insurance, maintaining bank accounts and obtaining accounting services. This is more stringent than Connecticut law, which generally permits such transactions as long as they are fair to the charity.

4. Limit on number of board members. A board of directors (or trustees) will be comprised of no less than three members and no greater than fifteen. This will override Connecticut law, which also requires no less than three members but sets no maximum.

5. Accreditation. To quote from the proposal: "There would be an authorization of \$10 million to the IRS to support accreditation of charities nationwide, in States, as well as accreditation of charities of particular classes

(e.g. private foundations, land conservation groups, etc.). ... The IRS would have the authority to contract with tax exempt organizations that would create and manage an accreditation program to establish best practices and give accreditation to members that meet best practices and review organizations on an ongoing basis for compliance. ... The IRS would have the authority to base charitable status or authority of a charity to accept charitable donations on whether an organization is accredited."

6. CEO financial certification. The chief executive officer (or equivalent) will sign a declaration under penalties of perjury that s/he has put in place processes and procedures to ensure that the organization's Form 990 complies with the Internal Revenue Code and that the CEO was provided reasonable assurance of the accuracy and completeness of the return.

7. Penalties for failure to file an accurate and timely Form 990. Fines will double or triple, depending on the size of the organization's gross receipts, for not filing a Form 990 on time or failing to file an accurate one. Extensions of greater than four months (that is, filing the return more than eight and one-half months from the end of the organization's fiscal year) will be considered a failure to file. Failure to file a return for two consecutive years could result in loss of tax-exempt status.

8. Disclosure of performance goals. "Charitable organizations with over \$250,000 in gross receipts would be required to include in the Form 990 a detailed description of the organization's annual performance goals and measurements for meeting those goals (to be established by the Board of Directors) for the past year and goals for the coming year."

9. Public disclosure of corporate contributions. Publicly-traded corporations will have to file with the IRS a return, available to the public, showing all gifts over \$10,000 (in the aggregate) for which the corporation claimed a deduction. This is not good news to charities (and their corporate donors) that, for whatever reason, prefer to keep that information private.

10. "Reform" of donor advised funds. Strict requirements will be placed on these funds, which are not currently regulated and, in the committee's view, are subject to abuse.

The list goes on but by now the idea is apparent. What is the nonprofit sector's response?

Several associations of nonprofit organizations testified at the June hearing and/or submitted written comment at a follow-up "roundtable discussion" with the committee in July. Among them were INDEPENDENT SECTOR and the National Council of Nonprofit Associations (NCNA), of which the Connecticut Association of Nonprofits (CAN) is a member. Anne Giliberto, CAN's chief operating officer, is a NCNA board member. Others testifying or submitting written comment include the IRS, the Section of Taxation of the American Bar Association and the Better Business Bureau Wise Giving Alliance. The written comments and other information, including the full text of the Senate Finance Committee's proposals, is available online at <http://finance.senate.gov>.

On September 22, 2004, Senator Grassley wrote to INDEPENDENT SECTOR ("IS"), encouraging IS to "convene an independent national panel on the nonprofit sector to consider and recommend actions that will strengthen good governance, ethical conduct and effective practice of public charities and private foundations. ... While we cannot be bound by your panel's work, we would welcome the recommendations that will be forthcoming from such a panel" The Senator asked that the panel's initial recommendations be made by February 2005 and a final report issued in the spring of 2005.

In response to Senator Grassley's request, IS established the panel, supported by an advisory committee, which in turn is supported by five working groups. The panel is comprised of twenty-four nonprofit and philanthropic leaders from a variety of public charities and private

foundations. Paul Brest, president, William and Flora Hewlett Foundation, of Menlo Park, California, and Cass Wheeler, chief executive officer, American Heart Association, of Dallas, Texas, are serving as panel "co-conveners." The eight-person advisory group is headed by Joel Fleishman of the Heyman Center for Ethics, Public Policy and the Professions at Duke University and Marion Fremont-Smith of the Hauser Center for Nonprofit Organizations at Harvard University.

The five working groups will focus on issues concerning financial accountability, governance, legal framework, oversight and self-regulation, and small organizations. Of local interest, I am a member of the oversight and self-regulation group and David Nee, executive director of the Hamden-based Graustein Memorial Fund, is on the small organizations working group.

The challenges for the nonprofit sector in this climate are serious and passage of some kind of legislation is probably inevitable. But with strong and persuasive input from the sector, the legislation that emerges can be narrowly focused to help prevent abuses without imposing unnecessary burdens on nonprofits. Please feel free to contact me at Wiggin and Dana at 860-297-3739 if you would like additional information or to offer suggestions.

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