

The Panel On The Nonprofit Sector Reacts To U. S. Senate Finance Committee Proposals

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In the previous issue of *The Nonprofit Advantage*, I wrote about proposals being floated by the U.S. Senate Finance Committee that will have profound effects on nonprofits if enacted into law. The proposals are sweeping, including new rules for nonprofit governance, donor-advised funds, deductibility of appreciated property, supporting organizations (such as "friends of" groups) periodic substantiation of eligibility for tax-exemption and so on. It is fair to say that these proposals and the vigor with which they are being pressed by the Finance Committee and others have put nonprofits under a spotlight not experienced since the Congressional hearings preceding enactment of the 1969 Tax Reform Act that completely rewrote the rules under which private foundations operate. Only this time, it is public charities - that is, charities that derive their support from public contributions, government funding and program service revenue - that are under scrutiny or, as some have put it, "assault."

In October 2004, Senate Finance Committee chair Charles A. Grassley, R - Iowa, asked Independent Sector - our sector's

largest trade group - to coordinate a response to the proposals. IS established the "Panel on the Nonprofit Sector," comprised of veteran and credentialed leaders in the sector (hereinafter, "the Panel"). The twenty-four person Panel is supported by work groups and advisory committees populated by experienced nonprofit practitioners from all around the country. IS is providing staff support. The over 150 people involved in this process are under considerable time constraints both because Senator Grassley has asked for a final report from the Panel by June 2005 and because the Senator intends to push ahead with hearings on the proposals even before the work of the Panel is completed. In fact, one such hearing was held on April 5.

The Panel has adopted the following principles to guide its work:

1. A vibrant nonprofit sector is essential for a vital America.
2. The nonprofit sector's effectiveness depends on its independence.
3. The nonprofit sector's success depends on its integrity and credibility.

4. Comprehensive and accurate information about the nonprofit sector must be available to the public.
5. A viable system of self-regulation is needed for the nonprofit sector.
6. Government should ensure effective enforcement of the law.
7. Government regulation should deter abuse without discouraging legitimate charitable activities.
8. Demonstrations of compliance with high standards of ethical conduct should be commensurate with the size, scale and resources of the organization.

In March, The Panel issued an interim report that focuses on four areas:

- Actions the sector can take on a voluntary basis to improve governance and ethical conduct;
- Ways to increase transparency of charitable sector operations;
- Additional legislation that is necessary to ensure that tax exempt dollars are used exclusively for charitable purposes; and
- Stronger enforcement of existing law by federal and state oversight officials.

Among the Panel's recommendations:

- Charitable organizations should encourage their boards or an appropriate board committee to review the Form 990 or 990-PF.
- When existing penalties for failure to file a required return after appropriate notice from the IRS do not result in compliance by the charity after two consecutive years or more, the IRS should be authorized to suspend the tax-exempt status of any charitable organization.

- The IRS should require that the Form 990 series returns be signed, under penalties of perjury, by the chief executive officer, the chief financial officer, or the highest ranking officer, or, if the organization is a trust, by a trustee of the organization.

- Every charitable organization, as a matter of best practice, should adopt and enforce a conflict of interest policy consistent with the laws of the state in which it is located and tailored to its specific organizational needs and characteristics.

- Charitable organizations should include individuals with some financial literacy on their board of directors in accordance with the laws of their state or as a matter of good practice. Every charitable organization that has its financial statements independently audited should consider establishing a separate audit committee of the board.

- All charitable organizations should establish policies and procedures that encourage individuals to come forward with credible information on illegal practices or violations of adopted policies of the organization.

- The term "donor-advised fund" should be statutorily defined to provide a basis for targeted rules addressing potential abuses of donor-advised funds, without discouraging use of such funds by donors.

- Targeted anti-abuse rules, accompanied by appropriate penalties, should be enacted to eliminate the inappropriate use of supporting organizations while maintaining the availability of such organizations for legitimate charitable purposes.

- States should be encouraged to incorporate federal tax standards for charitable organizations into state law, such as rules prohibiting excess benefit transactions.

- Congress should increase the resources allocated to the IRS for oversight and enforcement of charitable organizations and also for overall tax enforcement.

These recommendations do not address the most controversial of the Senate Finance Committee's proposals. The Panel will need to make some very difficult decisions in preparing its final report due out in June. Among the issues still to be addressed are:

- Whether inconsistencies in reporting between audited financial statements and Form 990 series returns should be addressed through the establishment of uniform standards in areas such as accounting of fundraising costs, restricted funds, and pledges for future contributions.
- Whether charitable organizations, other than houses of worship, should file information every five years to determine whether the organization continues to be organized and operated exclusively for exempt purposes. The Panel will examine the types of information that would be necessary to make this determination, the cost to charitable organizations of complying with these proposals and the cost of enforcing these proposals to determine the efficacy of such proposals and whether alternatives are available that meet the intended goal.
- Whether organizations with more than \$250,000 in gross receipts should include with their Form 990 a detailed description of annual performance goals and measurements for meeting those goals. The Panel will consider various proposals for how this might be accomplished, the value it might bring to donors and to charities and the cost of enforcing such a requirement for both the government and charitable organizations.
- Whether federal law should govern the structure, size and composition of Boards of Directors. A Senate Finance Committee proposal would limit Boards to fifteen members.
- Whether standards should be established for "independence" of Board Members, including a prohibition on directors doing business with the charity.
- Whether federal law should limit the amount a charity may spend on administrative expenses.
- Whether federal law should require that charities be accredited and what the criteria for accreditation should be.
- Whether Congress should establish a mechanism for providing education, training and technical assistance to charities.
- Whether new rules should be established for valuing non-cash contributions.
- Whether the U. S. Tax Court should have the authority to enter sanctions against Boards of Directors that breach their fiduciary duties. Historically, that authority has resided with the states.

Reaction to the Panel's interim report has been mixed. As of April 4, over two hundred charities have endorsed the Panel's report, including many community foundations and some of the nation's largest charities. Independent Sector is encouraging charities to support the Panel's conclusions.

However, the approach of the Panel, with its heavy emphasis on sector self-regulation, has its apparent critics. In his closing remarks to the April 5 Senate Finance Committee hearing, Senator Grassley said "Too often as charities across the country consider proposals for reforms, they do so in an atmosphere that doesn't reflect the reality we see [and] it is only natural that some charities respond as if the sky is falling. But the fact is that those who turn a blind eye to the problems in the charitable sector, or seek only a fig leaf of reform, potentially cause real long-term damage to non-profits. ... It is particularly vital that the panel provide us serious proposals that the IRS can efficiently administer in the areas of

self-dealing, governance and pay and benefits."

The Attorney General of Minnesota commented that: "Self-regulation, however, is no replacement for strong government regulation. Nonprofit directors and executives sometimes suffer from a "halo effect" in which they believe that because their mission is pure, their actions are above reproach. ... When the board and executives assume such an attitude, there are no shareholders to question their conduct; there is only the government to fulfill a role it has played for centuries."

Perhaps the most scathing comment came from the National Committee for Responsible Philanthropy, a long-time critic of what it sees as the charity establishment. "Despite having raised more than \$3 million to support their work, a panel of nonprofit leaders has generated paltry and picayune accountability recommendations that will accomplish little or nothing to cure the accountability problems facing the nonprofit sector."

Where this will all lead is anybody's guess; but it seems inevitable that some form of proposed legislation will emerge from the Finance Committee. The nonprofit sector should hope that, in the words of Senator Max Baucus (D-Mont), ranking minority member of the committee, "any reform effort needs to be a balance between cracking down on the bad guys, and not unduly burdening the good guys."

The Panel's interim report and the ability to express support for it are available online at www.independentsector.org

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