



**Testimony of
Diana Aviv
President and CEO
Independent Sector**

**United States House of Representatives
Ways and Means Subcommittee on Oversight
Hearing on Tax-Exempt Charitable Organizations**

July 24, 2007

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Chairman Lewis, Ranking Member Ramstad, and Members of the Committee:

Thank you for this opportunity to appear before you today. It's an honor to help provide an overview of our nation's charitable community, and to comment upon recent legislation and pending regulatory activities that will have a significant impact on the future of the nonprofit sector.

I am Diana Aviv, president and CEO of Independent Sector, a national, nonpartisan charitable organization with approximately 600 members, including public charities, private foundations, and corporate giving programs, collectively representing tens of thousands of charitable groups in every state across the nation. Our coalition leads, strengthens, and mobilizes the charitable community to fulfill our vision of a just and inclusive society and a healthy democracy of active citizens, effective institutions, and vibrant communities. IS members represent a broad cross-section of our nation's nonprofit community, which exists to meet society's needs, frequently in partnership with government, in diverse areas such as the arts, education, human services, community development, and health care.

My remarks today will focus on four topics. I will begin by giving you an overview of the charitable community, including a discussion of its health. Next, I will examine the essential partnership between government and the charitable community in improving lives. Third, I will describe the recent challenges and inspiring response of the sector and the government in strengthening accountability and transparency. Finally, I will discuss two significant challenges facing the community and propose solutions for the Committee's consideration.

State of the Sector

More than 170 years ago, Alexis De Tocqueville marveled in *Democracy in America* at how Americans came together to solve problems through voluntary associations. He came to see these efforts as one of America's most distinctive features. Today, America's charitable community plays an even more indispensable role in improving lives across the country and around the world. It has grown to encompass more than 1.5 million organizations, large and small, that engage people in securing basic needs, creating opportunities, offering hope, fostering creative expression, and nurturing our spirits.

We are religious and secular relief organizations that serve people in need. We are therapy centers for disabled children, inner city free clinics, and after-school programs. We are large and small foundations that fund services for the most vulnerable in our society, creative arts programs, and economic development. We are also small neighborhood groups, cleaning the roadsides, protecting

our children, and fighting for the causes we believe in. No matter who you are, or where you are in this country, your life is touched and enhanced by the work of nonprofit organizations.

America's charitable community produces its results because of the talent and dedication of caring people. Part of that service comes from volunteers, who collectively provide the equivalent of 9 million full-time staff members. Our organizations' results are also supported by its 11.7 million paid employees, 9 percent of the entire national workforce and a number greater than the finance, insurance, and real estate industries combined¹.

To do this important work also requires financial resources. The voluntary contributions of millions of Americans provide 20 percent of the revenues that support the programs our community offers. We rely on government funding for approximately 31 percent of our support, and fees for services – generally calibrated based on the client's ability to pay—provides 38 percent of the needed revenues. The remaining 11 percent of the support is derived from investment earnings, income from unrelated business activities, and other sources. Charitable organizations collectively spend nearly \$1 trillion annually to provide programs and services that improve lives and strengthen communities throughout the United States and the world. Add to that the value of countless hours of volunteer effort each year, and it is clear that the nonprofit community is a major and essential force for good in our society.

Partnership with Government

Throughout our history, the American people have relied on voluntary organizations to address the needs of many of our most vulnerable neighbors. In the colonial period, some groups who found themselves in the minority – Scotsmen and women in Massachusetts, for example, the Jewish community in South Carolina, and African-Americans in the South – had the opportunity to create their own organizations to help their members. The number of voluntary associations expanded significantly in the 19th century, leading to thousands of new organizations such as Jane Addams' Hull House and the African Meeting House in Boston. The first part of the 20th century witnessed further expansion in the number and variety of charitable organizations, from private universities to community centers, from foundations to health care providers.

As our nation grew and the problems facing our communities became more complex, we increasingly turned to government to help meet our collective responsibilities for ensuring the quality of life we want all people to enjoy. Some programs started by nonprofits—including libraries, local schools, fire stations, and parks—have been expanded by government, enabling the broader community to enjoy their benefits. At the same time, philanthropic institutions incubated new ideas—such as rocket science and the 9-1-1 emergency response system—that are now an integral part of the services government provides. In addition, charitable organizations are the partners through which government effectively and efficiently delivers services such as early childhood education, health clinics, drug counseling, and after-school programs. Without this vital collaboration between government and the charitable community, our nation would not address such needs nearly as well.

Congress and state legislatures have long recognized the critical role of nonprofit organizations dedicated to advancing the common good by granting them exemption from income taxes. This enables those organizations to devote their funds to fulfilling their missions. To encourage the

¹ Lester M. Salamon, editor. *The State of Nonprofit America* (Washington, D.C.: Brookings Institution Press, 2002).

American people to contribute, federal and state governments also have allowed taxpayers to deduct charitable contributions when calculating their income taxes.²

Several government agencies are charged with monitoring and regulating charitable organizations to ensure that they meet the conditions under which they were granted this special tax status. The Internal Revenue Service's Tax Exempt and Government Entities Division bears the primary responsibility for approving applications for tax-exempt status, and monitoring and enforcing compliance with the rules for tax-exempt organizations. In most states, attorneys general bear the primary responsibility for enforcing state laws governing the creation, operation, and dissolution of charitable organizations.

Although the system of oversight has proven effective in identifying and deterring some individuals or organizations that violate these laws, a serious shortage of resources has made it difficult for government officials to identify and punish many violators.

Accountability and Transparency

Starting in 2002, news outlets that had been following corporate scandals began to examine charitable organizations more carefully. They subsequently identified a number of cases involving practices that were illegal or not in keeping with standards typical of the charitable community. Some stories described individuals who received inappropriate personal economic benefits, others focused on unethical fundraising practices, inattentive boards of directors, and individuals claiming excessive contributions. Many leaders in the charitable community were troubled by these stories and wanted to explore ways we could strengthen oversight and improve the governance and accountability of our organizations. To begin a dialogue for change, I invited two dozen leaders among charities and foundations to come together.

The leaders of the Senate Finance Committee were also taking a closer look at charities and foundations, and in 2004 convened several hearings and a roundtable discussion, to examine oversight and needed reforms. That year, the House Ways and Means Committee launched its own examination of the charitable community, efforts by the IRS to improve compliance, and the need for further congressional oversight.

Many in the nonprofit community urged caution when considering new legislative options, particularly given the diverse ways in which charitable organizations operate. They noted that while a particular remedy might solve the targeted problem, it might also have unintended adverse consequences for a great many other organizations. The leadership of the Senate Finance Committee agreed that more thorough study was needed, and with their encouragement, Independent Sector expanded our initial analysis. The national Panel on the Nonprofit Sector was born. The result constituted the most comprehensive review of the governance, regulations, and operations of the charitable community in more than three decades.

² The Internal Revenue Code defines more than 25 categories of organizations that are exempt from federal income taxes, including private country clubs, business associations such as Chambers of Commerce or the National Association of Manufacturers, labor unions, fraternal organizations, and many others. Because charitable organizations – those defined under section 501(c)(3) of the tax code--must benefit the broad public interest by addressing specific types of programs, Congress has provided, with very limited exceptions, that they are the only tax-exempt organizations eligible to receive tax-deductible contributions.

The Panel consists of 24 distinguished leaders from public charities and private foundations from around the country. It was supported by five Work Groups that included a total of more than 100 experienced representatives of the nonprofit sector that examined key issues in governance and accountability. Also making major contributions were two advisory groups: one made up of technical experts, the other of leaders of America's business, educational, media, political, cultural, and religious institutions, who provided a broad perspective on how these issues affected the public at large. Two additional groups were later added to examine specifically how the annual information returns filed by charitable organizations, the IRS Forms 990 and 990-PF, might be improved.

The Panel adopted an inclusive and transparent process for its work, conducting 15 field hearings around the country, including in Atlanta, Minneapolis, and New York City, hosted several national conference calls, and posted all of its draft recommendations for comment on its website. Altogether, the Panel received comments from more than 15,000 people who improved the final product and lent their support to this massive effort.

In June 2005, the Panel presented its Final Report to Congress and in April 2006, it released a Supplemental Report. Together these reports contain a strong, carefully integrated package of over 130 recommendations for action that lawmakers, the IRS, and the sector itself could take to improve the governance and accountability of charitable organizations. The Panel identified areas of misconduct that were not covered by existing law, which was not surprising given that there had been no significant change in federal laws governing the nonprofit community in more than 30 years despite significant growth in the sector during that period. The Panel also recommended methods for strengthening existing law enforcement systems to facilitate a more streamlined use of resources.

In the Panel's view, the recommendations balance the need for meaningful oversight with the need to protect the independence that has been a hallmark of the charitable community's effectiveness. They also recognize the diverse range of needs and interests of charitable organizations, understanding that while one solution might be appropriate for larger organizations it could devastate smaller or new nonprofits. The Panel paid special attention to smaller organizations by creating a work group whose goal was to ensure that they were not adversely impacted by its recommendations.

The Panel's report was formally endorsed by 460 large and small organizations throughout the nation, from the American Cancer Society to the Boys and Girls Club of Carlsbad, California, from the Boston Foundation to the Georgia Center for Nonprofits. Many organizations have adopted governance policies and practices recommended by the Panel, and the Internal Revenue Service incorporated many of the Panel's recommendations in its recently released draft of a revised Form 990.

Legislative Developments

In the year following the release of the two reports, Independent Sector and many other nonprofit organizations consulted with Members of Congress and with tax staff of the Senate Finance Committee and the House Ways and Means Committee, encouraging them to enact legislation following the Panel's recommendations. The result was the package of legislative reforms passed by Congress with the Pension Protection Act of 2006 and enacted into law last August. Those reforms included increased fines and penalties for violations of prohibitions on excessive private benefits, clearer rules for appraisals required to substantiate tax deductions for charitable contributions, and new rules to ensure that assets held in donor-advised funds and supporting organizations are used to

benefit the intended charitable purposes. These reforms represent the most comprehensive change to the laws governing charitable organizations since the 1969 Tax Act and have significantly strengthened the legal framework that enables our charitable community to be a vital resource for our nation.

The inclusion in the Pension Protection Act of several new incentives to encourage charitable giving is also helping to generate new resources needed to support the work of charitable organizations. These incentives include the IRA Charitable Rollover, which allows older Americans to make charitable contributions from accumulated retirement funds without additional tax burdens; an enhanced tax deduction for gifts of property for conservation purposes; and enhanced deductions for corporate contributions of food and book inventory. Unfortunately, these incentives will expire at the end of this year unless Congress takes action to extend them.

Since its enactment, the IRA Charitable Rollover provision has encouraged tens of millions of dollars of new or increased contributions to help build cancer centers, develop programs for counseling at-risk youth, provide college scholarships, support housing for homeless families, conserve wilderness areas, and provide art therapy for people with developmental disabilities. Beginning at age 70 ½, all IRA owners are required to take annual minimum distributions, even if they do not need the income. While there are some large gifts that have been received by organizations, we are seeing around the country that smaller donations of \$4,000 to \$5,000 are being given by persons who might not otherwise have donated in the past. This new provision allows those who have accumulated more assets than they need to use that required distribution and other funds in their IRAs to give back to society by supporting their cherished causes on a tax-free basis. This is particularly helpful for older Americans who do not itemize their tax deductions and would not otherwise receive any tax benefit for their charitable contributions.

We thank the committee members who are co-sponsors of legislation introduced by Representatives Earl Pomeroy and Wally Herger to extend the IRA Charitable Rollover. This legislation would also expand the reach of this important provision by making all charitable organizations eligible to receive IRA Rollover donations, and provide IRA owners with the opportunity, starting at age 59 ½ to secure their own retirement income while giving to charity by using several planned giving options currently in the tax code. I would think this latter component would be of particular interest to all members of the Ways and Means Committee because it encourages Americans to give to charities and receive annuities in return, thus marrying the Committee's concerns for efficient giving and retirement security in the form of annuities. Extending and expanding the IRA Charitable Rollover would likely generate millions of additional charitable donations that would help improve lives and strengthen communities, and we urge that it be enacted before the current giving incentive expires at the end of the year..

Independent Sector also believes that some changes are needed to a few of the reform provisions in the Pension Protection Act. Private foundations and donor-advised funds should be permitted to make grants to supporting organizations, other than Type III supporting organizations that are not functionally integrated. Funds established by public charities and government entities should not be defined as, and subject to, many of the restrictions on donor-advised funds. We appreciate this Subcommittee's Advisory requesting comments on the Pension Protection Act and will be submitting more detailed responses.

In anticipation of a study on donor advised funds called for as a result of the legislation that will be completed and made public next month by the Treasury Department, we ask for the opportunity to work with the Committee to construct appropriate additional reforms.

One pressing issue that did not find its way into the Pension Protection Act that would go along way to enhance transparency and accurate reporting by charitable organizations, is the Panel's recommendation to require all charitable organizations to file their tax returns electronically. Accordingly, Independent Sector urges the Ways and Means Committee to extend mandatory electronic filing of Form 990 returns to virtually all charitable organizations.

Regulatory Developments

As I noted earlier, the Panel on the Nonprofit Sector also recommended changes in Treasury regulations, particularly in the annual information returns filed by charitable organizations, to improve accountability and transparency. The Treasury Department and the Internal Revenue Service consulted with Independent Sector and many other charitable organizations to develop quickly the regulations and advisory notices needed to implement and facilitate compliance with the Pension Protection Act reforms. We particularly appreciate their continuing efforts to help organizations clarify and correct their misclassification as supporting organizations and to assist grantmakers in obtaining information they need to comply with new restrictions.

Last month, the Internal Revenue Service published a draft of a significantly revised Form 990 return, the document that many nonprofit organizations must file with the Service. By separating information that applies only to a limited number of organizations into distinct schedules, standardizing the extensive number of attachments required on the current form, and clarifying the information organizations are expected to provide, the draft is a vast improvement for both filers and readers of the current form. Steve Miller and his team at the IRS are to be commended for an outstanding job in reaching out to the regulated community and for listening to our concerns. Their open and straightforward approach is another facet of the continuing partnership between the government and the nonprofit community.

Due to competing priorities within the Service, Steve and his team are operating under an extraordinarily tight deadline for implementing these changes. Independent Sector has been working with our members to provide feedback to the IRS on areas where the draft needs to be refined and corrected. For example, we believe that the "efficiency indicators"—that is, the percentage of funds and employee compensation devoted to particular activities—that the Service has included on the opening page of the Form are misleading and will not provide useful information to regulators or the public. We further have serious concerns about the dangers that new disclosures called for in the draft will create for individuals and groups working outside the United States that are part of or funded by American organizations. We are committed to ensuring that our charitable resources are not diverted to those who mean harm to our nation, but we also must ensure the safety of those who are working to improve the lives of people in parts of the world that are hazardous for workers or hostile to American organizations and interests.

We also recognize that the extent of the changes on the new form will require time to educate organizations about new definitions and requirements and to enable them to adjust their accounting and other record-keeping systems required for accurate reporting. We look forward to working with the IRS to develop an implementation schedule for the revised Form 990 that will allow rapid

implementation of positive changes without imposing unrealistic compliance demands on charitable organizations.

Challenges Facing the Charitable Community

Concerns about ethics and accountability should not overshadow the other significant challenges facing our nation's charitable organizations. Despite the welcome news of substantial donations by generous individuals like Warren Buffet and Bill Gates, growth in overall charitable giving has been very modest. According to a report in the July 21, 2007, issue of the *Chronicle of Philanthropy*, corporate giving declined by 10.5% in 2006, and giving by individuals increased only 1 percent after inflation. The article reports that Americans of modest means are finding it more difficult to give in the face of rising prices for fuel and other necessities and difficult economic conditions in many regions of the country.

At the same time, organizations that rely on grants and contracts from federal, state, and local governments to provide services have been affected by cuts and changes in funding priorities. In recent years, we have witnessed a decrease in the absolute dollar amounts (not just inflation-adjusted dollars) in the federal budget for non-defense domestic discretionary programs vital to the sector. Indeed, spending on non-defense discretionary services outside of homeland security has declined both as a share of the total federal budget and of the nation's economy. There have also been changes in the dollars allocated for and funding formulas for mandatory programs that affect services for needy individuals and families, raising the demand for services provided by charitable organizations.

Like other businesses and families, charitable organizations are facing rising fuel and operating costs, making the need for increased capital even greater. Some organizations have been forced to reduce services or abandon certain programs altogether. Some have increased fees while struggling to preserve access to services, while others have turned to developing business enterprises, which often require capital investments and business expertise that may be out of reach.

Charitable organizations are also facing declines in human resources. Financial and time demands have led to a decrease in the number of Americans who are able to volunteer time to charitable programs. In addition, the current generation of leaders of charities and foundations, like the rest of the baby boom generation, are expected to retire from these leadership positions over the next decade. It is estimated that the nonprofit sector will need 640,000 new senior managers (almost 2 1/2 times the number currently employed) to replace those retiring. There is no institution, mechanism, or program currently in place for identifying the next generation of nonprofit leaders and providing them the skills needed to make it thrive.

Many individuals create or come to work for charitable organizations with a wealth of passion and commitment for the causes they address, but with little knowledge or experience of the legal requirements and business skills necessary for success. While a number of consultants and management support organizations provide some training and assistance to help managers and boards of charitable organizations address these needs, the quality of these services and access to them varies greatly across the country. These outside resources are also not affordable to many smaller nonprofits. Like their counterparts in the small for-profit business community, nonprofit leaders could benefit substantially from the business planning services, financial and legal advice, and management training provided by the Small Business Administration.

We call upon this Committee and your congressional colleagues to give serious consideration to the creation of a **Small Nonprofit Administration** that would work to nurture and train leaders of charitable organizations in the administrative, governance, fundraising, and planning skills necessary to ensure that the people of our nation will continue to benefit from the vital services these organizations provide. While some federal agencies have developed programs to assist organizations they fund or contract with to provide services, it is time to pull these efforts together to ensure broad access to high-quality training and support for the thousands of organizations that work to ensure the health and vitality of people and communities throughout our nation. Independent Sector and our members stand ready to assist you in this important effort.

We appreciate the opportunity to testify before the Subcommittee and I am pleased to answer any questions you may have.