



INDEPENDENT SECTOR
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Before the United States House of Representatives
Committee on Ways and Means

Hearing on Economic Recovery, Job Creation and Investment in America

October 29, 2008

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The 25 percent rise in the number of unemployed Americans and the millions of families who have lost their homes to foreclosure over the past year can be seen in the growing lines of people coming to nonprofit organizations for the food, shelter, medical care, and financial and crisis counseling they need to survive this difficult economy. The numbers of individuals and families seeking assistance – and the types of assistance they are searching for – have expanded considerably as a result of the most recent economic developments. Millions of older Americans will be living in reduced circumstances because of the dramatic drop in their retirement savings; many young people can no longer access the loans they need to stay in school; and there has been an alarming rise in calls for help with domestic violence, depression, and substance abuse.

The same conditions that have expanded the numbers of people in need have also left the nonprofit organizations people turn to for assistance struggling. Cuts in government funding, coupled with diminished private resources and rising costs of doing business, have left nonprofits facing significant challenges in meeting the increased demand for services. As the Committee on Ways and Means and the Congress consider measures to address state and local government budget shortfalls, home foreclosures, and long-term unemployment, we offer five proposals that would also help our nation's charities and foundations provide the vital programs upon which communities throughout the nation rely. Specifically, we recommend simplifying the excise tax on private foundations, lifting the ceiling on individual giving above 50 percent of AGI, raising the annual cap on giving from individual retirement accounts, providing temporary transition relief from the new funding rules under the Pension Protection Act, and establishing a revolving loan fund to enable foundations to meet their commitments to communities.

Impact of State and Local Government Budget Crisis

Our nation's 1.5 million nonprofits receive roughly one-third of the funding they use to provide services to individuals and communities from government, and those that provide health and human services derive over 55 percent of their funding from government. As state and local governments have cut their budgets for these vital areas, many nonprofits have been forced to curtail programs, reduce their hours of service, or even close their doors.

The fiscal challenges facing state and local governments have hit charities hard. For example, New Jersey eliminated from its 2009 fiscal year budget \$42.4 million that was slated to cover the rising costs of nonprofits serving 500,000 people with developmental disabilities and mental illnesses, as well as children and families suffering from domestic violence and other problems. In New York, the 211 hotline program, which refers people in need to groups that can help them, was cut by more than 90 percent. Legal Aid in Sonoma County, California lost 15 percent of its operating budget when the county Human Services Department could not afford to renew its contract for Fiscal Year 2009, and the local YWCA may lose nearly \$700,000 in government funding. With at least 36 states experiencing fiscal stress¹, the likelihood of sweeping cuts in nonprofit programs is expanding while the need for those programs grows.

Declining Private Contributions

Private contributions from individuals, foundations, and corporations are another critical source of support for the programs and services nonprofit offer, comprising another 1/3 of the funding for nonprofit organizations. In the last two years, total private contributions have remained relatively flat, and a recent study by the Center on Philanthropy at Indiana University indicated that fundraising in the first half of 2008 was less successful than anticipated due to “the economic environment - including layoffs, corporate losses, stock market declines, and rising gas prices.”² The recent economic turbulence has caused many individual donors to hold back on their charitable contributions at a time when their support is needed even more. Many corporations have severely cut back or suspended their giving programs, and private foundations have experienced major reductions in their investment portfolios, which will mean substantial reductions in their grantmaking activities in the coming years. All of these factors indicate that nonprofits will continue to be hard pressed over the next few years to find the resources needed to continue, much less expand, vital programs and services.

Effects of the Credit Crunch

The current credit crisis has left many nonprofits without sufficient funds to meet current program obligations. In addition to their common practice of reimbursing nonprofit contractors only after they have incurred expenses, many state and local governments have delayed payments to nonprofits that are delivering vital community services. Without access to quick-turnaround, short-term, low-cost financial assistance, the nonprofits may find it impossible to provide necessary services such as supporting foster families caring for abused children or purchasing supplies needed for educational programs. Other organizations, such as health clinics, will be forced to cut back on the hours of service they provide to communities in need.

Some community and private foundations have been a critical source of such short-term loans for nonprofit organizations. The market downturn, however, has left many foundations with severely reduced financial resources, and some must now choose between

¹ Testimony of Iris J. Lav, Center for Budget and Policy Priorities, before the House Budget Committee, October 20, 2008.

² “Philanthropic Giving Index,” (Center on Philanthropy at Indiana University, July 21, 2008)

selling assets at the current depressed rates or failing to meet their funding obligations. Over time, these foundations may decide to cut back on the ongoing support they provide to vital programs and may not consider new requests to support programs developed to address emerging needs of individuals and communities.

To ensure that essential community programs are able to continue during this difficult economic period, short-term loans, using current assets as collateral, must be made available to both nonprofits that offer services and foundations that provide emergency assistance..

Rising Health Insurance Costs

Nonprofits are also facing challenges in retaining the skilled, experienced employees necessary to support their high-quality service programs because of the rising costs of health care coverage and retirement benefits. In the most recent study of nonprofit health insurance, researchers found that nonprofits “are being especially hard hit, experiencing higher than average health benefit cost increases and finding it necessary to shift a disproportionate share of the resulting burden on their already less well-paid employees in order to reduce the impacts on the populations they serve.”³ Smaller organizations, and particularly children and family services agencies, have been particularly affected by rising insurance premiums. In addition to layoffs and reduced hours of work, the study found that organizations have been forced to raise fees or cut services to their communities.

This year, these challenges have only grown, and nonprofits are increasingly forced to lay off workers, adding to the unemployment rolls, or reducing or eliminating the health care coverage they provide to employees. Both actions reduce the amount and quality of services nonprofits can provide. Because nonprofits, as tax-exempt organizations, do not benefit from employer tax credits and similar proposals for addressing health insurance cost and coverage issues, it will be necessary to find other methods to ensure that this vital group of workers are not forgotten in the quest to make affordable health care accessible to all.

Defined Benefit Plan Obligations

Nonprofit organizations that provide defined benefit pension plans to their employees are being particularly hard hit by new funding obligations enacted with the Pension Protection Act of 2006. As tax-exempt organizations, nonprofits offer retirement benefits not as an opportunity to take a tax deduction, but as a means for attracting and retaining qualified employees committed to serving their communities. The Pension Protection Act of 2006 significantly increased the funding obligations for pension plans, which nonprofits have endeavored to meet. The abrupt market decline has turned those obligations into a severe problem never anticipated when the act was drafted. Specifically, organizations will be required to restore the market losses of upwards of 35 percent of assets in only seven years, starting next year. Even if nonprofits freeze their pension plans to curb costs, this provision will require nonprofits to divert millions of dollars away from programs at the time they are needed most.

³ Lester M. Salamon and Richard O’Sullivan, “The Health Benefits Squeeze: Implications for Nonprofit Organizations and Those They Serve.” *Communiqué No. 3*. Baltimore: The Johns Hopkins Center for Civil Society Studies, October 2004.

Recommendations

In addition to measures the Committee is considering to respond to the state and local government budget shortfalls, home foreclosures, and long-term unemployment, we strongly urge the Committee to consider the following five measures that could help nonprofits to provide the critical services our communities need.

1. **Lift the ceiling on individual giving:** Congress should temporarily allow individuals to give more than the current ceiling of 50 percent of their adjusted gross income. Under current law, the amount allowed as a charitable deduction in any taxable year may not exceed fifty percent of an individual's adjusted gross income. When Congress raised this limit to encourage giving in response to Hurricane Katrina and more recently the Midwestern floods, Americans responded by digging deeper to help their neighbors. The current economic crisis warrants a similar incentive to help the millions of Americans who need the services, solace and support nonprofit organizations offer.
2. **Raise the annual cap for gifts to charity from IRA holdings:** Congress should temporarily allow older Americans (age 70 ½ and older) to give back to their communities through nonprofit organizations in amounts beyond the current annual cap of \$100,000 when they feel their accumulated retirement resources exceed the amounts they require to meet their own needs.
3. **Simplify the excise tax on private foundations** so that foundations are not penalized for increasing gifts in times of greatest need. Private foundations that maintain a minimum distribution rate averaged over a five-year period are currently subject to a one percent excise tax on their investment holdings, whereas those that substantially increase their distributions in a given year may be subject to a two percent tax rate. Significant increases in distributions at times like these inflate the rolling average, requiring additional spending in subsequent years to avoid the higher tax rate. The current two-tiered taxing system, therefore, has the perverse effect of discouraging foundations from increasing their distributions for charitable purposes during times of greater need. This disincentive should be corrected either by eliminating the excise tax or by replacing the current two-tiered tax with a single-tier rate.
4. **Establish a Revolving Loan Fund:** Congress should establish a temporary revolving loan fund that would provide short-term loans with a reasonable interest rate to nonprofit organizations that are facing short-term cash flow problems due to delayed payments from government contracts and private grants. Existing contracts and grant commitment letters could be used as collateral, and financial institutions involved in the broader economic recovery program could administer such a fund. The fund could also be available to help foundations meet their commitments to charitable works in the near term without having to sell assets that are temporarily but significantly undervalued.
5. **Defined Benefit Obligations:** Congress should provide relief to nonprofit organizations that sponsor defined benefit pension plans by extending the transition period for implementing the new funding obligations enacted as part of the Pension Protection Act of 2006, by allowing flexibility in choosing funding election methods, and

by permitting smoothing of unexpected losses. Without this relief, nonprofits that sponsor defined benefit plans will be forced to meet the unexpected losses that occurred as a result of the market downturn by shifting substantial financial resources away from vital community services.

Independent Sector is 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.