TAX EXEMPT ORGANIZATIONS

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

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WEDNESDAY, MAY 16, 2012

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to call, at 10:05 a.m., in Room 1100, Longworth House Office Building, the Honorable Charles Boustany [Chairman of the Subcommittee] presiding.

[The advisory of the hearing follows:]

HEARING ADVISORY

Boustany Announces Hearing on Tax Exempt Organizations

Wednesday, May 16, 2012

Congressman Charles W. Boustany Jr., MD (R–LA), Chairman of the Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing examining operations and oversight of tax-exempt organizations. This will be the first in a series of hearings by the Subcommittee on the tax-exempt sector and IRS oversight of tax-exempt activities. **The hearing will take place on Wednesday, May 16, 2012, in Room 1100 of the Longworth House Office Building, beginning at 10:00 A.M.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing. A list of invited witnesses will follow.

BACKGROUND:

Tax-exempt organizations have long played an important role in the United States. Since the first income tax was imposed in 1913, certain organizations have been exempt from taxation, including those organized and operated for religious, charitable, scientific, or educational purposes. Such organizations remain the most common types of exempt organizations and are defined in section 501(c)(3) of the Internal Revenue Code ("IRC"). In addition to the longstanding exemption for such organizations under section 501(c)(3), there are 28 other types of organizations that may qualify for tax-exempt status.

As of 2008, 1.85 million organizations qualified for tax-exempt status, and 1.18 million qualified as charitable organizations under section 501(c)(3). In 2008, charitable organizations had $2.5 trillion in assets. It is estimated that tax-exempt organizations employ approximately 10% of the U.S. workforce (charitable organizations employ 7% of the U.S. workforce).

Tax-exempt organizations are subject to a variety of rules to ensure compliance with Federal tax law and limit abuses, including rules that prevent private inurement, limit certain activities, and subject business income related to for-profit activities to income tax.

On October 6, 2011, Chairman Boustany sent a letter to the Internal Revenue Service (IRS) seeking information related to the agency's administration and oversight of tax-exempt organizations (including charitable organizations). The letter sought information on a variety of topics to help the Committee understand the current state of relations between the IRS and tax-exempt entities, and provide a foundation for further engagement in overseeing this important sector of the U.S. economy. The letter focused on a number of issues related to corporate governance and compliance, requested information related to new reporting requirements for tax-exempt hospitals, and asked for an update on the ongoing Colleges and University Compliance Project that was launched in 2008.

In announcing this hearing, Chairman Boustany said, **"Oversight of the tax-exempt sector is an important priority for the Subcommittee, and it has been an area that both Republicans and Democrats agree needs greater attention. In my letter to the IRS last October, I asked the IRS about recent efforts to address certain concerns that have been raised regarding the operation of tax-exempt organizations, including corporate governance issues and mishandling of funds by officers. It is now time for the Subcommittee to hear from members of the tax-exempt community for a more complete picture of the current state of affairs. This review allows us to examine the**

state of the tax-exempt sector, as it currently exists today and consider this information as we continue the Committee's efforts toward comprehensive tax reform. In both cases the goal is the same—to ensure that the tax-exempt sector is operating in an efficient manner and that the laws governing tax-exempt organizations are being applied fairly and evenly."

FOCUS OF THE HEARING:

The hearing will focus on certain current issues related to tax-exempt organizations, including the current IRS compliance initiative related to Universities, recently enacted reporting requirements for tax-exempt hospitals, recent efforts by tax-exempt organizations to design and implement good governance standards, and taxpayer involvement in redesigning the Form 990. In addition, the hearing will discuss the history of recent legislative changes to the Tax Code dealing with tax-exempt organizations and what prompted those changes.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit written comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "Hearings." Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the online instructions, submit all requested information. ATTACH your submission as a Word document, in compliance with the formatting requirements listed below, **by the close of business on Wednesday, May 30, 2012**. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–3625 or (202) 225–2610.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone, and fax numbers of each witness.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://www.waysandmeans.house.gov/*.

Chairman BOUSTANY. The subcommittee hearing will come to order. Welcome to this morning's hearing on tax-exempt organizations. This hearing will be the first in a series of hearings exploring tax-exempt issues and related IRS compliance efforts.

Tax-exempt organizations, especially charitable organizations, serve an important role in our society. From the local Little League to nonprofit hospitals to major universities, tax-exempt organizations are intertwined with our communities and economy.

Tax-exempt organizations also control vast resources. It is estimated that in 2008 charitable organizations had $2.5 trillion in assets. In addition, tax-exempt organizations employ 10 percent of the workforce. With so many Americans relying on, working for, and engaged in economic relationships with tax-exempt organizations, taxpayers should have confidence that tax-exempt organizations, especially charitable organizations, are operating efficiently and hopefully using good governance practices to maximize benefits provided to the community. To support these goals it is important that this committee review the substantive rules that apply to tax-exempt organizations, IRS compliance efforts, and the operations and governance of tax-exempt organizations.

In addition, Congress must ensure that the IRS has the information it needs to effectively interact with tax-exempt organizations. The IRS is charged with ensuring tax-exempt organizations are operating in furtherance of their tax-exempt purpose and it is important that tax-exempt organizations and the IRS effectively communicate with each other to meet this goal.

With this in mind, in October of last year I sent a letter to Commissioner Shulman to discuss a variety of current issues involving tax-exempt organizations and IRS compliance efforts. Today we have invited witnesses who can provide information from the tax-exempt sector's perspective on the issues that were raised in my letter, such as good governance and compliance, the IRS college and universities compliance project, and new reporting requirements for nonprofit hospitals.

In addition, we have a witness who can provide historical background about recent changes in tax-exempt rules and the general structure of the tax-exempt sector. This is an opportunity to hear from the tax-exempt community on these important issues and learn what the current landscape looks like for tax-exempt organizations.

I want to thank all of our witnesses for joining us here this morning. With that I will now yield to my friend Mr. Lewis, the ranking member of the subcommittee.

Mr. LEWIS. Thank you, Mr. Chairman. Thank you, Chairman Boustany, for holding this hearing today. Tax-exempt organizations play an important role in our society. There are many types of tax-exempt organizations and each type serves an important role. There are organizations that help our poor and feed our hungry. There are colleges and universities that educate our young people and hospitals that care for our sick. There are also organizations that touch every corner of our life: religion, labor and the arts, and advocate on our behalf. In total there are over 1.8 million tax-exempt organizations that work to make our lives and our communities better.

Throughout the year I have been concerned about the IRS budget and the effect of the budget cuts on tax administration. The IRS currently has a budget of $100 million, and fewer than 900 employees to oversee nearly 2 million organizations that have more than $1 billion in revenue and $2.5 trillion in assets.

I continue to be concerned that, not if properly funded, the Agency harms taxpayers and in this context harms the public trust when bad actors are discovered. I look forward to learning more about the tools used to ensure compliance with the Federal tax laws.

In closing, I am mindful that tax reform is looming. If we adopt a Republican goal of a top individual tax rate of 25 percent, some tax preferences will need to be eliminated. However, I believe that tax-exempt organizations play a major, valuable, and necessary role in our economy and in our country, and charitable giving should be encouraged. I look forward to hearing from the witnesses today and I want to thank each witness for your testimony and thank you for being here.

And with that, Mr. Chairman, I yield back.

Chairman BOUSTANY. Thank you Ranking Member Lewis.

Next it is my pleasure to welcome the excellent panel of witnesses seated before us today. Today's witnesses have extensive experience studying or working with tax-exempt organizations and their experience will be very helpful as we examine the current state of the tax-exempt sector.

First I would like to welcome and introduce Mr. Roger Colinvaux. Professor Colinvaux is an associate professor of law at Catholic University and an expert on matters relating to nonprofit organizations. From 2001 through 2008, Professor Colinvaux served as legislation counsel with the Joint Committee on Taxation. Mr. Colinvaux, welcome.

Second, we will hear from Ms. Diana Aviv. Ms. Aviv is the president and CEO of Independent Sector, a national network of nonprofit organizations, foundations, and corporate giving programs. Before working at Independent Sector, Ms. Aviv worked as the associate executive vice chair for the Jewish Council of Public Affairs. Welcome, Ms. Aviv.

To introduce our third witness I am pleased to yield to my friend, the gentleman from New York, Mr. Reed.

Mr. REED. Thank you very much Mr. Chairman for yielding. And it is my honor and privilege to introduce to the committee a witness, the third witness on our panel today, Joanne M. DeStefano, Cornell University's vice president for finance and chief financial officer. She has custody and control of the university funds and has general responsibility for the maintenance of the financial records of the entire university. She oversees the comptroller's office, the treasurer's office. She holds an MBA from Cornell University. And before that, she worked for the private sector for Race Mark International, Inc. and Slumberge, Incorporated. She and I both live in the beautiful area of the Finger Lakes of New York. And it is my pleasure to introduce her in one of her first testimonies to the committee, and I know it will not be her last, having had the privilege of reading her testimony before it was given here today.

And with that, I yield back and welcome her for her testimony.

Chairman BOUSTANY. Thank you Mr. Reed, and welcome, Ms. DeStefano.

Fourth, we will hear from Mr. Michael Regier. Did I pronounce it correctly?

Mr. REGIER. Yes.

Chairman BOUSTANY. Senior vice president of Legal and Corporate Affairs for VHA, Incorporated. VHA is the Nation's largest alliance of nonprofit hospitals serving members in 47 States. Welcome, sir.

And finally we welcome Mr. Bruce Hopkins, senior partner at Polsinelli Shughart in Kansas City, Missouri. Mr. Hopkins has published multiple treaties on nonprofit tax issues and is a former chair of the American Bar Association's Committee on Tax Exempt Organizations.

I want to thank you all for being here today and spending time with us. The committee has received each of your written statements and we will make those part of the formal hearing record. Each of you will be recognized for 5 minutes for your oral remarks. And Mr. Colinvaux, we will begin with you. You are recognized for 5 minutes, sir. Thank you.

STATEMENT OF ROGER COLINVAUX, ASSOCIATE PROFESSOR, COLUMBUS SCHOOL OF LAW, THE CATHOLIC UNIVERSITY OF AMERICA, WASHINGTON, D.C.

Mr. COLINVAUX. Thank you. Thank you, Mr. Chairman, Mr. Ranking Member, Members of the Committee. Thank you for inviting me to testify today and for holding this hearing. The (c)(3) sector is a vital and dynamic part of our civil society, but it is also a sector with its share of business interests, bad actors, and vested interests as well. In part for this reason, the law governing our tax-exempt organizations is increasingly complex and also adrift.

I am here today to express my concern that the law is developing without a clear sense of the Federal role or a tax policy towards (c)(3) organizations. Now, we first granted exemption about 100 years ago and the law has changed a lot. For one thing (c)(3)s have to apply for their status and report annually. They didn't when we started. (C)(3)s face restrictions on some of their activities like campaigning and substantial lobbying, but initially there were no activity restrictions. (C)(3)s must pay tax on some types of income, their unrelated business income, and private foundations pay tax on their investment income, so we don't have a blanket exemption anymore. Some (c)(3)s also are preferred over others. Public charities face many more restrictions than private foundations, so not all charities are still treated equally.

So over time, Congress has placed limits on exemption. But what is interesting is that these limits are mostly negative in nature. That is, what we have said is, don't do this or don't do that or please file a form with the IRS as you go along. But we haven't really required anything affirmative of (c)(3) organizations. That is, we don't say that they must do anything to secure their status. Thus, we have kept the broad purposed-based approach to exemption under which it is relatively easy to become a (c)(3) and remain one.

We have also kept the all-or-nothing approach to exempt status making the main tool IRS has for enforcement, revocation of status, which because it is so drastic is also a somewhat limited tool. The results I believe are legal standards that facilitate growth but little in the way of oversight capability, in large part because there is not much for the IRS to measure. This can lead to problems and it has. In recent years we have seen far too many (c)(3) organizations associated with scandals and we have had legislation as a result.

Now, I want to talk about this legislation for a few seconds because it highlights what I see as the current trends in the law. First, Congress has shown frustration with the breadth of the (c)(3) exemption standard.

First, in the case of credit counseling groups and then in the case of hospitals, Congress decided to impose more rigorous exemption requirements on these organizations than other (c)(3)s. This, in my view, is very significant because it treats some (c)(3)s worse than others based on the organization's purposes. We haven't done that before. What this means is that the sector can be broken down into its component parts, disaggregated, with legal standards tailored to each organization type.

Second, Congress has shown a willingness to blur the line between public charity, and private foundation, in several cases adopting the bright-line anti-abuse rules applicable to private foundations and applying them to stop abuses at public charities. This matters because it suggests that the old way for distinguishing (c)(3)s as public or private is less relevant today and that abuses can and do occur at public charities.

However, rather than selectively applying foundation rules to abuses of public charities, it might be better to reexamine this distinction entirely. We can look at each abuse, decide if it is still a concern, and, if so, for which type of (c)(3).

The final related trend to emerge is that Congress is showing a preference for brighter enforcement lines, more intermediate sanctions, and so frustration with the current facts and circumstances approach to enforcement. All these trends are important because they show the current direction of the law. We have a disaggregation of the sector based on purpose, a weakening of the public charity, private foundation distinction and a preference for bright, if harsh, enforcement lines.

Now, going forward, I think the question is whether to continue on this path, and here I see a fork in the road. Right now the path is focused on abuse. Policymakers respond to abuses with new rules, and stopping abuse and protecting the integrity of the sector are very important goals. And in my written testimony I highlight some ways we might consider to focus on that.

Another avenue for tax reform is to reconceive of the role the Federal Government has to (c)(3) organizations. Our current approach is somewhat monolithic. We tie all the tax benefits to (c)(3) exemption. Why not instead focus on areas where the Federal interest is the greatest: on support for charitable contributions; and decide whether eligibility to receive contributions should depend on the satisfaction of new criteria, perhaps based more on activities and outcomes rather than purposes?

I see I am out of time. I recognize the very important goal of oversight. And thank you for inviting me to testify today.

Chairman BOUSTANY. Thank you Mr. Colinvaux.

[The prepared statement Mr. Colinvaux follows:]

Testimony of Professor Roger Colinvaux[1]
Before the House Committee on Ways & Means,
Subcommittee on Oversight
Hearing on Tax Exempt Organizations
May 16, 2012

Mr. Chairman, Mr. Ranking Member, Members of the Committee, thank you for inviting me to testify today, and for holding this hearing. I believe that the laws regulating the section 501(c)(3) sector are in need of a critical look, and welcome the opportunity to provide my observations about the current state of the law.[2]

In sum, I offer a descriptive account, in an effort to better understand the development of the law, and to explain its increasing complexity. The central tenets of my account are that recent legislation has established new legislative precedents that run counter to the traditional regulatory approach: precedents for distinct exemption standards based on the type of organization, a weakening of the basis for distinguishing among charities as "public" or "private," and a related preference for brighter enforcement lines and frustration with the status quo. These trends make for growing complexity, but are in large part a reasonable response to the historic legacy of defining a sector based on broadly conceived purposes and the inherent difficulties of oversight that follow. Going forward, it is critical to assess the federal role in support of the section 501(c)(3) sector, and at a minimum, take steps to further the integrity of the sector by minimizing opportunities for abuse. More broadly, if the federal approach is to be reconceived, the tax policy focus should shift to greater promotion of activities rather than purposes, and require more from the sector than avoiding bad outcomes.

A. Background

Under federal tax law, an organization that is "organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes" is tax preferred. This single legislative phrase provides a standard not just for tax exemption for over a million organizations (which are diverse in purpose, size, function, complexity, and effectiveness)[3] but also is a gateway to several tax and nontax preferences, including eligibility to receive tax deductible contributions (for income, estate, and gift tax purposes), access to tax-exempt financing, State property tax exemptions, and regulatory relief, among other benefits.[4] The section 501(c)(3) designation includes large national organizations with many millions of dollars of revenue, and small local organizations with gross receipts under $5,000.[5] The result is invariably referred to as the "nonprofit sector," the "charitable sector," the

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[1] Associate Professor of Law, Columbus School of Law, The Catholic University of America. Legislation Counsel, Joint Committee on Taxation, 2001-2008.

[2] Portions of this testimony are based on my article: *Charity in the 21st Century: Trending Towards Decay*, 11 FLA. TAX REV. 1 (2011), and available for download at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1809171

[3] The National Center for Charitable Statistics at the Urban Institute maintains an informative coding scheme for charitable organizations, available at http://nccsdataweb.urban.org/PubApps/nonprofit-overview-sumRpt.php?v=ntee&t=pc&f=0.

[4] See Staff of Joint Committee on Taxation, 109th Cong., Historical Development and Present Law of the Federal Tax Exemption for Charities and Other Tax-Exempt Organizations, at Appendix (Joint Comm. Print 2005); Evelyn Brody, All Charities are Property Tax-Exempt, But Some are More Exempt Than Others, 44 New Eng. L. Rev. 621 (2010).

[5] One recent estimate provides that the section 501(c)(3) designation covers over 1.1 million organizations, with revenues in one year of approximately $1.4 trillion, and asset holdings of approximately $2.6 trillion. Molly F.

"independent sector" – but for purposes of my testimony, I will use the phrase "section 501(c)(3) sector." This is because the identity of the sector stems not exclusively from its nonprofit status, charitable nature, nor independence, but rather from its relationship to this iconic section of the tax code.

B. Historical and Current Legal Characteristics of the Section 501(c)(3) Sector

The initial exemption was passed in 1913 and had several notable characteristics: (1) The exemption was self-enforcing – there was no requirement that the organization apply for the exemption or report regularly. (2) No explicit limits were placed on activities.[6] (3) The exemption was a complete or blanket exemption, that is, it covered all of an organization's income. (4) The exemption applied equally to all organizations meeting its terms. (5) The exemption was all or nothing: either the organization met the requirements and was free from income tax or it did not meet the requirements and was subject to income tax. (6) The exemption was conditioned on a "good" purpose and no effort was made to define purpose in concrete terms, based on outcome, content, or other quantifiable measure. (7) The exemption was conditioned on the private inurement restriction; that is the profits of the organization were required to go to the good purposes of the organization, and not be paid out to private persons or private interests. (8) The standard for tax exemption was used as a basis for other, distinct tax benefits; for example, as of 1917, the language of the exemption provided a basis for the charitable contribution deduction.

It is not surprising that 100 years later, the law has changed. Section 501(c)(3) status is not self-enforcing, but is conditioned upon an explicit determination by the Internal Revenue Service ("IRS") and subject to ongoing oversight through the filing of annual information returns. Congress also decided that certain activities were inconsistent with tax exemption: for example, section 501(c)(3) organizations may not participate in political campaigns or engage in substantial lobbying. Further, the exemption is not a blanket exemption. All charitable organizations are subject to tax on income from business activities that are not related to the organization's section 501(c)(3) purpose; and some section 501(c)(3) organizations (i.e., private foundations) are subject to tax on their investment income. Finally, the exemption no longer applies equally to all. Section 501(c)(3) organizations are divided into broad categories: public charities and private foundations; with the former being preferred to the latter for purposes of the charitable deduction, tax exemption, and permissible activities and surveillance.

These changes are all significant legal responses to experience with section 501(c)(3) organizations over the course of a century. Yet much of the foundational statutory laws and historical approaches to section 501(c)(3) status and enforcement have remained the same. The two core statutory requirements of the 1913 exemption are unchanged: section 501(c)(3) exemption still (importantly) requires a generically "good" purpose;[7] and the exemption still is conditioned on the private inurement restriction. In addition, the requirements for the charitable deduction remain linked to the requirements for section 501(c)(3) exemption, i.e., the law does not require separate tests for two rather different tax benefits. Further, section 501(c)(3) status remains, for all intents and purposes, an either/or proposition.

Sherlock & Jane G. Gravelle, Cong. Research Serv., R40919, An Overview of the Nonprofit and Charitable Sector 3, 9-12 (2009) (reporting as of July 2009 and not including organizations that do not report to the IRS on the annual information return (Form 990 series) such as churches and small organizations).

[6] In 1919, however, the Treasury adopted a regulation for purposes of the charitable contribution deduction of 1917 stating "associations formed to disseminate controversial or partisan propaganda are not educational within the meaning of the statute." Reg. 45, art. 517 (1919), in T.D. 2831, 21 Treas. Dec. Int. Rev. 285 (1920).

[7] Of course, a century's worth of experience provides considerable precedent as to what qualifies as a section 501(c)(3) organization as determined over time by the IRS and the courts.

Revocation of exemption, which is based on an inquiry into all the facts and circumstances, remains the primary sanction for failure to meet a condition of section 501(c)(3) status.[8]

C. Observations Regarding Historical Changes

Thinking, broadly, about what has changed and what has stayed the same, a number of observations can be made. First, the historical trend is toward more restrictions on the section 501(c)(3) designation. What began in 1913 as a fairly straightforward and sweeping tax exemption, has been incrementally pared back and subjected to more rules and requirements. Section 501(c)(3) organizations must apply for their status (with churches a principal exception), may not engage in certain activities, must pay tax with respect to some income, and some organizations will be treated better than others.

Second, these restrictions generally have taken the form of negative rather than positive requirements. Positive requirements are the things a section 501(c)(3) organization must do to secure and keep its status. By contrast, negative requirements are the things a section 501(c)(3) organization must refrain from doing. In other words, section 501(c)(3) organizations have been asked to refrain from doing certain things, such as politicking or lobbying, or engaging in (untaxed) business activity. But section 501(c)(3) organizations have not, in general, been asked to do anything affirmative, apart from file forms.[9] Thus, the century's narrowing of the 501(c)(3) designation has occurred not through an effort to limit eligibility for the preference or to demand something quantifiable in return for tax benefits, but through rules that constrain the scope of the preference once eligibility has been established.

A third observation relates to a consequence of a century of retreat from the scope of the original tax preference in the form of negative and not positive restrictions: the facilitation of a large and growing section 501(c)(3) sector. Without positive requirements, becoming and remaining a charity is relatively easy. And although a charity in 2012 faces a lot more rules and restrictions than a charity of 1913, apart from a vague entreaty to remain "operated" for its purpose, the exemption, once granted, is unlikely to be withdrawn. Further, the pluralistic approach toward defining section 501(c)(3) organizations means that the definition evolves to accommodate societal change and as it does so, the activities encompassed by section 501(c)(3) grow. In addition, because the requirements for the charitable deduction are linked to requirements for section 501(c)(3) exemption (and other benefits), the amount of support provided by the federal government to the sector via the section 501(c)(3) designation also naturally increases along with the scope of the exemption standard.

A fourth observation relates to enforcement. Overall, the risk of audit for a section 501(c)(3) organization is low. But to a certain extent, the examination rate as such is beside the point. Even if there were a dramatic increase in resources and a corresponding uptick in audits and examinations, there likely would be little meaningful change in growth or in the nature of organizations qualifying for section 501(c)(3) status. This is because, at least with respect to public charities, there is very little "hard" law for the IRS to enforce. In general, the IRS is limited to an inquiry into "purpose," with the thrust of the inquiry being not on the substance of the purpose, or the direct accomplishments of the organization, but on the more ethereal inquiry into whether the organization really is benefiting private interests more than public ones. Importantly, this existential question is the heart of the matter primarily because of the absence of anything positive to measure and the all-or-nothing, facts and circumstances nature of enforcement. An organization either qualifies as a 501(c)(3) organization or it does not, there is no middle ground. Further, because the sanction is severe, an already delicate query is to a certain extent

[8] There are exceptions. Excise taxes, or intermediate sanctions, may be imposed on self-dealing transactions and excess lobbying. IRC § 4941, 4958, 4911.

[9] The principal exception to this is imposition of a pay out requirement on private foundations. IRC § 4942.

tilted in favor of the organization. Revocation of the 501(c)(3) designation is a serious step, and, as a practical matter, is not (and should not be) undertaken lightly. This leaves the IRS with very little other than the somewhat limited tool of intermediate sanctions to try to deter and punish bad behavior, which in any event has very little to do with overseeing the accomplishments of the organization.

A final related observation is that the consequences of regulation by negative restriction and the relative absence of bright enforcement lines are beginning to stress the viability of the regulatory system and the section 501(c)(3) designation. The all-or-nothing nature of the tax preference combined with the vague positive requirement to be operated for section 501(c)(3) purposes and no other positive measure, has limited the ability of the IRS, for better or for worse, effectively to police abuse or to check the growth of the section 501(c)(3) sector in any meaningful way, or even to provide any strong degree of confidence that the organizations receiving the section 501(c)(3) moniker, typically at the outset of their existence, meet their promises or are actually serving a public benefit. The outcome is a large and growing section 501(c)(3) sector and legal standards that accommodate growth.

D. Trends Exemplified by Recent Legislation

Growth without measureable standards is conducive to problems. Although the section 501(c)(3) form is vital, it is also relatively easy to abuse and hard to enforce. And so in recent years, scandals have too often been associated with section 501(c)(3) organizations, at some considerable cost to the "halo" effect of the sector as a whole. Scandals have involved certain iconic institutions, contributions of noncash property, participation in tax shelter transactions, spending and management abuses at private foundations, concerns about grant-making public charities such as donor-advised funds and supporting organizations, scandals in the hospital and credit counseling industries, and excess compensation to name some of the more prominent.

Scandals led to significant section 501(c)(3) reform legislation over the past several years. These legislative responses are telling, quite apart from the substance, in that the legislation highlights growing tensions within the current tax policy framework. For one, through the legislation Congress in effect has said that the breadth and amorphous nature of the section 501(c)(3) standard is too generous. For another, Congress has expressed disaffection with the current basis for distinguishing among charities as "public" or "private." And for a third, Congress has begun to approve brighter lines over facts and circumstances approaches to enforcement. It is important to see how these trends are being articulated through legal changes because they provide the best sense of the current direction of the law.

(i) Frustration with the breadth and amorphous quality of the section 501(c)(3) exemption standard

Although the open-ended standard for exemption yields the benefits of a diverse sector, it also comes with costs. As noted, the lack of affirmative standards makes measurement and enforcement difficult, a problem magnified by the size of the sector. Alternatives might be to require that some threshold of activity be met, to narrow the scope of the section 501(c)(3) standard, or even to impose guidelines on how money is to be spent and for whose benefit. Another, less divisive, response is to focus on process. Positive but process-oriented requirements do not mandate that a specific type or amount of a public good be provided, but nonetheless require action by the 501(c)(3) organization, action intended to facilitate production of the public good. The reform legislation took significant steps toward a more process-oriented approach.

Credit counseling organizations are an example. In response to abuses, Congress took credit-counseling organizations out of the generic framework of section 501(c)(3), and provided a series of distinct bright-line standards for section 501(c)(3) status. Accordingly, credit counseling organizations must satisfy several extensive requirements, including rules about the composition of the governing body, rules requiring a reasonable fee policy (one that requires provision of services even if the consumer does not have the ability to pay), categorical rules about permissible practices, rules about ownership of related entities, and rules limiting the amount of allowable revenue from certain sources.

Such statutory precision regarding the conditions of section 501(c)(3) status for a particular type of organization was unprecedented. It represented a significant conceptual shift, considering that the general operating principle of section 501(c)(3) has been that all public charities are created equally; that is, if you have a "good" purpose, the law will not adversely discriminate because of such purpose.[10] Even when Congress created second-class citizenship for private foundations, foundations generally were disfavored because the foundation form could lead to abuse, and not because of the substance of foundation activity. By contrast, credit-counseling organizations now are singled out by their purpose, and special rules are applied on this basis.

Hospitals are another example. As a class, hospitals are perhaps the most prominent part of the section 501(c)(3) sector, and have long raised questions about the meaning of the section 501(c)(3) exemption standard. This is because many section 501(c)(3) hospitals may seem indistinguishable from taxable for-profit hospitals. Both, after all, perform similar functions. In general, the legal difference is that a section 501(c)(3) hospital must provide a "community benefit." But this standard has been widely criticized for its lack of a positive measure. Accordingly, a policy question has been whether section 501(c)(3) hospitals should be subject to affirmative positive requirements, such as mandating some free or charity care as a condition of section 501(c)(3) status.

In response, in 2010 Congress adopted new exemption standards for section 501(c)(3) hospitals. To maintain 501(c)(3) status, hospitals must, among other things, and in addition to generally applicable standards, conduct a "community health needs assessment" at least once every three years, establish a written financial assistance policy and a written policy relating to the provision of emergency medical care, limit the amount of charges to certain patients for emergency or other medically necessary care, and refrain from engaging in "extraordinary collection actions" without first making reasonable efforts to discover whether a patient is eligible for financial assistance. New reporting requirements and excise taxes also apply.

It is noteworthy that these new standards do not impose a substantive positive requirement on section 501(c)(3) hospitals; rather, the legislation settles for process-oriented rules that are designed to promote a more charitable outcome. For example, the financial assistance and emergency care policies, and requirements to stop overcharging the indigent and performing unreasonable collections are anti-abuse oriented: i.e., focusing on stopping manifestly uncharitable behavior. Although important, this of course is different from affirmatively requiring charitable activity. The community health needs assessment comes closer to imposing an affirmative charity standard. By requiring section 501(c)(3) hospitals formally to seek input from and assess the needs of their communities, the legislation aims to force hospitals to consider how they are integrated within and accountable to the communities they serve, and, therefore, to take active steps to foster a community (and charitable) benefit. Notably, however, the legislation stays well on the side of process, providing no hint as to what a community benefit might be substantively.

The credit counseling and hospital-specific legislation not only highlight the difficulty of imposing substantive positive requirements, but also show that Congress continues to wrestle with the all-

[10] There is some affirmative discrimination based on purpose: churches, hospitals, and colleges and universities are generally considered to be "public charities" (and not private foundations) by definition—that is, based on their purpose. IRC § 509(a)(1).

or-nothing nature of section 501(c)(3) status. For example, most of the new hospital requirements are conditions of section 501(c)(3) status. In theory at least, this means that if a charitable hospital violates a requirement, for example by engaging once in an unreasonable collection activity, the hospital's 501(c)(3) status is revoked. This outcome is highly unlikely, however, making these new requirements (and others like them) aspirational in nature--i.e., a sanction is plausible only in the most egregious of cases. Thus, these efforts to tighten the standards for section 501(c)(3) status show how difficult it is to regulate behavior when there are no positive obligations to enforce and the principal sanction is revocation of 501(c)(3) status. This difficulty is evidenced by the fact that the Treasury Department and the IRS have not yet issued administrative guidance that describes the consequences of or penalties for noncompliance with the additional exemption requirements.

(ii) Erosion of the public charity-private foundation distinction

Initially, the law made no distinction among section 501(c)(3) organizations: all in effect were treated equally. Yet, as time passed, the "private" foundation was singled out for adverse treatment. The private foundation is defined in the negative, as something other than a "public" charity. Some organizations are deemed public because of their function and role in the community: hospitals, colleges and universities, and churches. Most other organizations must satisfy a public support test. The theory is that all such "public" organizations will be overseen effectively by their donor or service-based community. Such oversight, lacking for a private foundation, means in theory that the public charity is less susceptible to abuse, and so should escape additional regulation. In effect, by distinguishing public charity from private foundation in this way, Congress assumed that public charities did not raise the same concerns, either as a matter of form or substance.

The consequences of being public or private are stark. Operationally, a comprehensive anti-abuse regime – a series of negative restrictions – applies to private foundations, and is enforced by stiff excise taxes. The anti-abuse rules target four areas: self-dealing between the foundation and foundation insiders, excessive ownership of a for-profit business, the making of risky investments, and spending for non-exempt purposes. In addition, private foundations are subject to a key positive requirement – they must pay out a percentage of investment assets each year for exempt purposes. Private foundations also are disfavored for purposes of the charitable deduction rules; and most private foundations must pay a tax on investment income. Public charities face far fewer restrictions.

The existence of the public-private distinction is important because it demonstrates in law and policy a preference for certain categories of 501(c)(3) organization over others. It also presents alternative regulatory approaches, giving policymakers a base from which to regulate abuse generally. Thus, the recent wide array of reported scandals at public charities tested the underlying theory of the public-private distinction, raising the question whether additional anti-abuse rules were necessary for public charities. For example, if self-dealing at public charities is not sufficiently addressed by current law, should the less forgiving private-foundation self-dealing rules be applied? Similar questions could be asked of all the private foundation anti-abuse rules.

Although the ongoing efficacy of the public-private distinction was not directly addressed in the reform legislation, Congress made liberal use of the private foundation rules in reforming two types of public charity: donor advised funds and supporting organizations. Here, Congress applied private foundation-like rules in the areas of the charitable deduction, self-dealing, payouts for exempt purposes, excess holdings of a business, and nonexempt purpose expenditures.

While utilizing private foundation rules for these types of public charities may be a natural and appropriate response, the more the private foundation rules are applied to public charities, the less distinct public charities and private foundations become. Indeed, it is likely that with each new scandal at a public charity, the pressure will increase to extend the private foundation anti-abuse rules to cover the new scandal.

The trouble with such a selective incorporation approach, however, is that it neglects to address the underlying issues. Granted that our current system treats some 501(c)(3) organizations better than others, does the current basis for doing so make sense? Should we assume that some 501(c)(3) organizations are inherently deserving of "better" treatment because of their function, or sources of support? Or can we draw different lines? Rather than selectively incorporating aspects of the private foundation regime to public charities, a more sensible approach might be to reexamine the basis for the distinction altogether and analyze each abuse currently regulated and decide the extent to which the abuse remains a concern, and if so, with respect to what types of 501(c)(3) organizations. Should all section 501(c)(3) organizations be subject to an excise tax for non-exempt purpose spending? Should there be tax consequences to imprudent investing for any type of section 501(c)(3) organization? Should we distinguish 501(c)(3) organizations for purposes of the charitable deduction, not just on the basis of whether the organization actively conducts a program (as opposed to primarily making grants), but also on the type of program or public good provided?

(iii) Toward brighter enforcement lines

One response to abuse of section 501(c)(3) organizations is for more and better enforcement of the laws. But one of the difficulties with a "more enforcement" argument, apart from the political question of resources, is the question of standards for enforcement. For public charities, there are no measurable affirmative obligations and few anti-abuse rules. Enforcement is largely of broad purpose requirements or of negative restrictions that depend intensively on facts and circumstances determinations: for example, no private inurement, no private benefit, no intervention in a political campaign, and no substantial lobbying.[11] Further, because of the all-or-nothing nature of 501(c)(3) tax exemption, enforcement for public charities generally means the drastic step of revocation of charitable status. The chief exception to revocation is the intermediate sanctions or excess benefit transaction rules, but these are fairly generous as compared to the private foundation rules on self-dealing, are process-oriented, and fairly limited in scope.

More effective enforcement might depend on a new legislative approach: brighter lines and, perhaps, positive requirements. There is evidence that the legislative policy is beginning to shift in this direction. Precise standards imposed on credit counseling organizations and the private foundation-like rules that apply to donor advised funds and supporting organizations are each modest confessions that additional enforcement tools are needed to police certain abuses. In addition, these provisions show a preference for brighter lines in enforcement over the prevailing facts and circumstances or value-based standards for imposition of sanctions.

Even stronger evidence of a shift is found in the rule enacted in 2006 designed to stop participation by tax-exempt organizations in tax shelter transactions. The provision imposes a 100 percent excise tax on proceeds attributable to knowing participation by a tax-exempt organization in a "prohibited tax shelter transaction." Notably, the tax applies even absent knowing conduct, though the rate is reduced in such cases to 35 percent.

In enacting this provision, more than any of the other reform provisions, Congress changed the ground rules for tax-exempt status. As a policy matter, the provision stands for the proposition that it is

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[11] With respect to lobbying, section 501(c)(3) organizations that make an election under section 501(h) of the Code are subject to an extensive set of regulatory rules, and so are not subject to the default facts and circumstances "no substantial part" test.

fundamentally inconsistent with tax-exempt status to engage in conduct that enables tax evasion. True to form, it is a negative restriction, but unlike some of the other broad negative restrictions (no substantial lobbying, no political intervention), it was written with a strong deterrent that does not require revocation of tax-exempt status. And consistent with the anti-abuse approaches taken with respect to donor advised funds and supporting organizations (following the private foundation approach), the rule in effect stops the transaction, without allowance for much in the way of facts and circumstances ambivalence. In short, the rule provides the IRS with a strong, previously lacking, enforcement tool.

Going forward, the question is the extent to which this trend will continue. Although bright lines can have inequitable outcomes, their administrative appeal is manifest. As the public charity-private foundation distinction breaks down and the section 501(c)(3) sector continues to grow, there will be increasing pressure for more certainty in tax enforcement through imposition of bright-line rules.

E. Concluding Observations: Tax Policy and Section 501(c)(3)

In general, over the course of a century, notwithstanding dramatic change in the scope and diversity of the section 501(c)(3) sector, and so of the aggregate value of the tax benefits, most legal change has been in the form of negative requirements or process-oriented positive requirements and not in the imposition of substantive positive obligations. Although the initial exemption of 1913 has been significantly restricted in many ways, key fundamental traits have remained relatively untouched: the broad purpose-based approach to qualification as a section 501(c)(3) organization, the all-or-nothing approach to enforcement for public charities, and the policy of linking multiple tax benefits to a determination under section 501(c)(3). The result has been a large, growing, and diverse section 501(c)(3) sector, but also a sector, especially with respect to public charities, that is proving increasingly difficult to oversee.

Recent reform legislation shows that the law is wrestling with the remaining legacies of the initial approach to section 501(c)(3) exemption. Clear trends that emerge are frustration with the breadth of the standard under section 501(c)(3) and with the all-or-nothing, facts and circumstances-based means of enforcement. The result has been piecemeal reform: a fragmentation of the section 501(c)(3) sector based on purpose (but an unwillingness or inability to measure the purpose), and a gradual but selective blending of the public charity-private foundation distinction. This piecemeal reform approach has some predictive capacity. As new scandals are reported, the law will likely continue to shift in the direction now cast - following the lead of credit counseling organizations and hospitals, and further disaggregating the sector. And the law likely will continue to borrow anti-abuse measures from the private foundation regime and selectively apply them to public charities on a case-by-case basis.

Such piecemeal reform, certain to have detractors, nevertheless should be viewed as a consequence of the reluctance to impose substantive positive obligations on section 501(c)(3) organizations. In the absence of a positive standard for exemption and the presence of a growing sector, when it comes to oversight, there may be little choice but to draw additional lines based on form and not substance. This may result in formal compliance, with greater emphasis placed on functional categories and process: such as through governance initiatives, greater disclosure and transparency, community-based input and accountability, and brighter (if harsh) enforcement lines to police abuses.

Key questions going forward are whether additional reform is necessary along the lines established, whether the status quo is acceptable, and whether the current system has become too complex. My suggestion is to start from first principles – and to debate anew the relationship of the federal tax law and private, "good purpose" organizations. My overarching concern is that our law is developing without a clear understanding of the federal legal role. To what extent does tax exemption warrant regulation? What types of entities does the government seek to promote? Should the government care how an exempt organization spends its money? Is there a federal tax policy with respect to "charities"? The answers to these questions are not easy – but attempting to answer them is important.

At a minimum, protecting the integrity of the sector (the "halo"), and easing its administration, should be a top priority. In my view, Congress could advance this goal by focusing on ways to keep section 501(c)(3) organizations from abusive arrangements. One way would be to reconsider the current tax incentives for noncash charitable contributions. Many of the scandals of the past decade involved such contributions, which encourage donors and section 501(c)(3) organizations alike to engage in transactions that often yield questionable public benefits. The cost is not just to the Treasury, but to tax administration and to the reputation of the sector. Another is to ensure that the rules enacted to prevent tax-exempt organizations from participating in tax shelter-like arrangements are working. A third is, as a general principle, to tighten or maintain current borders, such as the rules against campaign activity, substantial lobbying, the unrelated business income tax, and private inurement (through tougher intermediate sanctions). Although some would argue that some borders should be expanded, to allow campaign activity for example, I think it important to recognize that further dilution of section 501(c)(3) purposes could lead to even more abuse and a less "charitable" sector.[12]

More broadly, my testimony is intended to emphasize that the current regulatory approach is largely ineffective – in part because there is no clear goal for oversight. Is the goal just to minimize abuse, or to promote a public good (other than the presence of a large and diverse section 501(c)(3) sector)? The purpose-based approach is increasingly complex, yet by focusing on purposes not activities, the system's added complexity does little to promote or reward positive "charitable" output, and continues to facilitate unchecked growth in an environment of dwindling tax administration resources. This may not be sustainable.

If the present approach to the section 501(c)(3) sector is to be reconceived, it is important to recognize that much of the federal interest in section 501(c)(3) organizations stems from the charitable deduction and other tax benefits, and less from tax exemption. Accordingly, the tax policy focus could, and in my judgment should, be on whether the eligibility standards for other tax benefits, especially the charitable deduction, should be tightened, including by changing from a deduction to a credit. Focusing on the tax policy in support of charitable donations would lead, appropriately in my view, to greater emphasis on promoting activities, such as certain types or levels of output of public goods, rather than merely curbing abuses. Ultimately, this is the precise role of Congress to decide the types and quantum of charitable outcomes and activities that should be encouraged and rewarded by the federal tax system, and the tax benefits to be used for such purposes.

The section 501(c)(3) sector is widely praised and admired for its contributions to society and as representing much of what is best in our nation: a dynamic civil society that fosters volunteerism, altruism, and community. But the section 501(c)(3) sector also is a "sector," replete with business elements, inefficiencies, bad actors, and vested interests. The federal tax system's support for the section 501(c)(3) sector is longstanding, but also to a certain extent adrift. There is no simple remedy – but this hearing is an important step toward more effective oversight.

Thank you for inviting me to testify, and I welcome any questions.

[12] My forthcoming article, *The Political Speech of Charities in the Face of Citizens United: A Defense of Prohibition*, addresses this issue (available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1726407).

Chairman BOUSTANY. Ms. Aviv, you may proceed.

STATEMENT OF DIANA AVIV, PRESIDENT AND CHIEF EXECUTIVE OFFICER, INDEPENDENT SECTOR, WASHINGTON, D.C.

Ms. AVIV. Thank you, Mr. Chairman, Representative Lewis, and Members of the Subcommittee for this opportunity to testify. I serve as the president and CEO of Independent Sector, which is a national coalition of nearly 600 public charities, foundations, and corporate giving programs and, that, with their affiliates, total tens of thousands of charitable organizations across the United States.

Every day charitable organizations work to provide help for families in need, assist victims of disaster, enhancing the cultural, physical, and spiritual life of communities, and foster the democratic values of justice and individual liberty.

These life-changing programs, as well as the 13.5 million jobs and $670 billion in annual wages provided by the nonprofit sector, are made possible in part by the generosity of Americans who contribute millions of hours and billions of dollars to support the charitable causes they care about.

The difficult economy has affected both charitable giving and the need for services from charitable organizations. Annual giving dropped $30 billion between 2007 and 2009, and has not yet fully recovered to pre-recession levels. At the same time, charitable organizations have struggled to meet payroll or hire additional workers as they work to keep pace with the dramatic increase in demand for services. According to a study by the NonProfit Research Collaborative, human service organizations, for instance, saw a 78 percent increase in demand in 2010.

Congress can help by immediately passing the expired tax extenders package which includes the IRA charitable rollover and enhanced deductions for donations of food.

As you look towards tax reform, we also ask you to keep in mind the positive impact of tax incentives for charitable giving on the people we serve, and explore ways to expand those incentives.

Because charitable giving depends in part on the high level of public trust in our sector, nonprofit organizations are deeply committed to ensuring effective and transparent governance, maximum accountability, and ethical conduct.

Independent Sector, with the encouragement of congressional leadership, convened the Panel on the Nonprofit Sector, which in 2005 issued a report that recommended improvements within the sector, more effective oversight and changes in the law.

The Pension Protection Act of 2006 included many of the provisions from our report, such as increased financial penalties for bad actors, safeguards against the use of charitable assets for personal gain, and improved information sharing between Federal and State oversight agencies.

The recently redesigned IRS form 990 also reflects many panel recommendations. As a publicly available document, the Form 990 has become an important accountability and transparency tool, and we are therefore keenly interested in IRS efforts to make further improvements. One issue of particular interest is removing barriers to electronic filing, which will improve the quality and accuracy of data, promote accountability and transparency, and save time and money for donors, nonprofits, and the government.

Using data from the redesigned Form 990, the IRS is evaluating whether good governance leads to better compliance. Their preliminary analysis of data from 1,300 returns shows a statistically significant positive correlation between a number of governance practices and tax compliance.

The nonprofit community also recognizes the importance of self-regulation. To that end, the Panel issued The Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations, which outlined 33 recommendations designed to improve compliance, governance, financial oversight and fund-raising practices. Almost 200,000 copies of the principles have been downloaded and used to develop governance policies, adjust board responsibilities, and offer guidance for those seeking to improve their practices.

Taken together, the actions outlined in my written statement—legislative, regulatory and voluntary—have strengthened governance and improved oversight of tax-exempt organizations, and they reflect a deep mutual commitment on the part of Congress, the IRS, and charitable nonprofit organizations to accountability, transparency, and good governance. They have also allowed charitable organizations to maintain the public trust that is key to continued confidence in and support for our work.

Mr. Boustany, Mr. Lewis, and Members of the Subcommittee, thank you for the opportunity to share these perspectives with you.

Chairman BOUSTANY. Thank you Ms. Aviv.

[The prepared statement of Ms. Aviv follows:]

INDEPENDENT SECTOR

STATEMENT FOR THE RECORD
DIANA L. AVIV
INDEPENDENT SECTOR, PRESIDENT AND CEO

HOUSE WAYS AND MEANS COMMITTEE
SUBCOMMITTEE ON OVERSIGHT
"HEARING ON TAX EXEMPT ORGANIZATIONS"
MAY 16, 2012

Chairman Boustany, Representative Lewis, and distinguished Members of the Subcommittee, thank you for the opportunity to share the perspectives of America's charitable sector as the Subcommittee examines oversight of tax exempt organizations.

I serve as the president and chief executive officer of Independent Sector, a national coalition of approximately 600 public charities, foundations, and corporate giving programs that with their affiliates total tens of thousands of charitable organizations across the country. Our nonpartisan coalition leads, strengthens, and mobilizes the nonprofit and philanthropic community in order to fulfill our vision of a just and inclusive society, as well as a healthy democracy of active citizens, effective institutions, and vibrant communities. We work to ensure that America's 1.3 million charitable organizations are able to help people and improve communities across the country and around the world.

Importance of the Nonprofit Sector

Every day, charitable nonprofit organizations provide educational and economic opportunities for families in need, work to alleviate poverty and suffering at home and abroad, assist victims of disaster, enhance the cultural and spiritual development of individuals and communities, and foster worldwide appreciation for the democratic values of justice and individual liberty that are part of the American character.

Cities, suburbs and rural communities in every corner of the United States are enriched by the work of nonprofit, philanthropic, and religious organizations. The United Way of Southwest Louisiana, for example, has supported the educational and social development of children by providing quality after-school and summer programs for 32,901 children in 2009, and the Second Harvest Food Bank of Greater New Orleans and Acadiana fights hunger in southern Louisiana through food distribution, advocacy, education, and disaster response, serving more than 260,000 people each year.

In response to April 2011 tornadoes that destroyed 600 homes in Georgia, American Red Cross volunteers and staff provided 486 people safe haven in Red Cross shelters, served 49,703 meals, and distributed 10,754 bulk items, including diapers, baby formula, insect repellant, dust masks, and more. On a daily basis, the Points of Light Institute, based in Atlanta, puts people at the center of transforming their communities through enterprises like the Hands on Network, whose 250 volunteer centers in 16 countries around the world partner with more than 70,000 corporate, faith, and nonprofit organizations to deliver approximately 30 million volunteer hours valued at over $626 million each year.

The charitable nonprofit and philanthropic sector is also a critical component of the nation's economy. Nearly one in 10 workers in the U.S. is employed by a nonprofit organization, and with 13.5 million employees, we employ more people than the finance and real estate sectors combined. Further, we collectively pay nearly $670 billion annually in wages and benefits – salaries that support middle class families in communities across America -- and in 2008, 501(c)(3) organizations paid $32.4 billion in payroll taxes.[1]

In addition, charitable nonprofit organizations inspired 62.8 million American adults to contribute more than 8 billion hours of volunteer service in 2010, the equivalent of 4 million full-time jobs valued at approximately $173 billion.[2]

The nonprofit sector's broad community impact and public support is evidenced by the breadth of its funding sources. Millions of Americans make donations each year, collectively providing nearly $300 billion[3] to support the work of charitable nonprofit organizations. But charitable donations are only part of what is needed to ensure that the sector's programs and services can continue. More than 52 percent of revenue across the sector is derived from fees paid for services, ranging from tuition and patient care charges to event admission fees. An additional one-third of nonprofit sector revenue is generated through partnering with all levels of government to deliver programs and services like after-school care, nutrition assistance, and health care services.[4]

Impact of the Economic Downturn

The struggling economy has made it more difficult for charitable organizations to serve their missions, as America's nonprofits have been hit hard financially in recent years. The Nonprofit Finance Fund, a community development financial agency, surveyed over a thousand nonprofit organizations in April 2010, and found 12 percent operating above a break-even point.[5] Sixty two percent of organizations had enough cash on hand to cover less than three months' worth of expenses, and half of those (31 percent) had enough for less than one month.

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[1] IRS data. http://www.irs.gov/taxstats/charitablestats/article/0,,id=97176,00.html

[2] Corporation for National and Community Service, "Volunteering in America," 2011

[3] Giving USA Foundation (2011). Giving USA 2011: The Annual Report on Philanthropy for the Year 2010. Chicago: Giving USA Foundation

[4] National Center for Charitable Statistics (NCCS), The Urban Institute, The Nonprofit Almanac 2011. Sources of Revenue for Reporting Public Charities: NCCS calculations of IRS Statistics of Income Division Exempt Organizations Sample (2007); NCCS Core Files (2009); American Hospital Association (AHA) 2009 survey; and the National Health Accounts, produced by CMS.

[5] Nonprofit Finance Fund, "2011 State of the Sector Survey," 2011

Like our counterparts in other major sectors of the economy, many nonprofit employers have struggled to meet payroll during the past three years, and countless more have been unable to hire additional workers needed to keep pace with an increased demand for services. In 2009 alone, 38 percent of human services nonprofits reported laying off employees, 50 percent froze or reduced salaries, and 23 percent reduced employee benefits.[6]

These financially challenging times have also seen a significant increase in demand for help for those most in need, as documented in numerous recent studies. One such study, conducted by the NonProfit Research Collaborative, found that human services organizations experienced a 78 percent increase in demand for services between 2009 and 2010.[7] Earlier, an annual survey conducted by Catholic Charities found that its agencies had served 9,164,981 people in 2009, an increase of nearly 19 percent increase from 2007.[8]

Many charitable nonprofit organizations have struggled to keep pace with this increased demand in part because they saw revenues fall during the economic downturn. From 2007 through 2009, annual charitable giving declined by almost $30 billion[9] as Americans struggled to navigate a difficult economy. Federal, state, and local budget cuts have further burdened and diminished the capacity of nonprofits, and this has disproportionately affected people who are least able to help themselves.

There are meaningful ways in which Congress might help charitable organizations secure the support they need to deliver these much needed services. Specifically, we ask that you enact the expired tax extenders without delay. It is difficult to overstate the urgency for our community, and the people we serve, of immediately reinstating the charitable giving incentives in the tax extenders package, which include the IRA charitable rollover as well as enhanced incentives for the donations of food, books, computer equipment, and land conservation easements.

More broadly, as Congress looks toward comprehensive tax reform, we ask you to keep in mind the value of charitable giving to the work of public charities and private foundations, and the important role of tax policy in encouraging that giving. We know that Americans give generously to the causes they care about; we also know that how much and when they give is influenced by incentives in the tax code. There is perhaps no better illustration of this than the fact that more than 22 percent of all annual online charitable donations in the U.S. are made on December 30 and 31,[10] as taxpayers seek to make donations before the deadline to claim a charitable deduction. Millions of lives are improved every day because our tax laws encourage people to give, and I urge you to explore ways to increase the impact of those incentives.

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[6] Elizabeth T. Boris, Erwin de Leon, Katie L. Roeger, and Ileana Nikolova, "Human Service Nonprofits and Government Collaboration: Findings from the 2010 National Survey of Nonprofit Government Contracting and Grants" (Urban Institute, October 2010).

[7] The NonProfit Research Collaborative, *November 2010 Fundraising Survey*. 2010. http://www2.guidestar.org/ViewCmsFile.aspx?ContentID=3117

[8] Catholic Charities USA, 2009 Annual Survey Final Report, 2009. Center for Applied Research in the Apostolate, Georgetown University, Washington, DC, July 2010. (http://www.catholiccharitiesusa.org/NetCommunity/Document.Doc?id=2392)

[9] Giving USA 2011, The Annual Report on Philanthropy for the Year 2010

[10] "Online Giving Study: Donations Driven by Donor Experience, Year End Gifts and Large Scale Disasters," Network for Good and True Sense Marketing, Dec. 2010

As the Committee looks ahead and prepares for tax reform, it may also be instructive to look back to the Tariff Act of 1894, which first exempted from federal income tax organizations operated for charitable purposes, and the Revenue Act of 1917, which first made donations to charitable organizations tax deductible. In both instances, Congress embraced the entire range of social purposes and important causes that citizens - individually or collectively - might choose to pursue through charitable organizations. Whether focused on the arts, social services, scientific research, or spiritual matters, this great American tradition has sparked innovation, saved lives, and enriched our communities. Through the wisdom of these decisions, Congress established century-old policies that have stimulated charitable giving, and made it clear that our government and our society value the contributions made by every charitable organization.

Good Governance: Importance and Background

Charitable nonprofit organizations understand that continued support from Americans who give of their time and money depends upon the high level of public trust in our sector, and that erosion of that trust will ultimately harm those we serve. We are therefore deeply committed to ensuring that public charities and private foundations are governed effectively and transparently, maintain maximum accountability, demonstrate the highest levels of ethical conduct, and fully comply with the law.

Independent Sector has long been at the forefront of efforts to promote good governance and ethical practice among tax-exempt charitable organizations. In October 2004, we convened the Panel on the Nonprofit Sector with the written encouragement of Congressional leaders of both parties. The Panel undertook a comprehensive review of governance and other aspects of charitable sector practice in order to develop recommendations for action by Congress, the IRS, and the sector itself that would help charitable organizations maintain the highest possible standards of ethical conduct.

The 24-member Panel conducted extensive outreach to solicit input and comments from the broader charitable community. This outreach included the creation of six committees [1] that met regularly; phone calls with thousands of participants; two public comment periods; and 15 field hearings that gave more than 2,500 people in communities ranging from Des Moines to Dallas the opportunity to provide input on the Panel's work. The Panel ultimately issued a *Final Report to Congress and the Nonprofit Sector* in June 2005, which contained an integrated package of more than 120 recommendations for improvements within the sector, more effective government oversight, and changes in the law.

The Panel's Advisory Committee on Self-Regulation was charged with examining the state of self-regulation in the nonprofit community and recommending improvements. In its earliest deliberations, the Committee agreed that self-regulation was necessary for our community to encourage strong governance, financial oversight, and accountability. A number of the Panel's final recommendations, as well as the subsequent *Principles for Good Governance and Ethical Practice,*

[1] Expert Advisory Group, Governance and Fiduciary Responsibilities Work Group, Government Oversight and Self-Regulation Work Group, Legal Framework Work Group, Transparency and Financial Accountability Work Group, and Small Organizations Work Group.

focused on steps exempt organizations could take to improve their own accountability, transparency, and ethical standards.

These Panel recommendations for improved self-regulation included:

- Board review of the Form 990 prior to filing, as well as periodic board review of governing instruments, financial transactions and compensation policies;
- Board approval of CEO compensation;
- Disclosure of donor advised funds owned;
- Adoption of policies governing travel reimbursement, and a prohibition on reimbursement for spouses, dependents, or others travelling with a board member;
- Adoption of conflict of interest policies and whistleblower protections; and
- Discouraging the compensation of board members.

Many of the Panel's legislative and regulatory recommendations were incorporated into the Pension Protection Act of 2006, widely considered to be the most comprehensive reform of the charitable sector since the 1969 Tax Reform Act. Among the key Panel recommendations adopted by Congress were:

- Doubling the excise taxes for charities, social welfare organizations, private foundations, and exempt organization managers found to be participating in abusive tax shelters;
- Requiring exempt organizations with annual gross receipts less than $25,000 to file an annual notice with the IRS containing basic contact and financial information;
- Clarifying that assets in donor advised funds may not be used in ways that confer substantial benefits on donor/advisors;
- Removing barriers that prevent information sharing between state charity officials and the IRS; and
- Improving the appraisal process to ensure more accurate deductions for donated property.

Additionally, Panel recommendations were an important part of the nonprofit community's input into the major redesign of the Form 990 subsequently undertaken by the IRS. The IRS worked closely with Independent Sector and conducted extensive outreach to members of the charitable community during the redesign process. Panel recommendations that were ultimately adopted by the IRS or incorporated in the Form 990 redesign included:

- The mandatory revocation of exempt status for organizations that fail to file an appropriate Form 990 for three consecutive years;
- Expanded Form 990 compensation reporting, to include listing names and reporting compensation for the organization's five most highly compensated employees;
- Requiring additional information, including a summary and statement of purpose on the first page, disclosure of which voting board members are independent, and disclosing the total amount of donor advised funds; and
- Asking whether an organization has a written conflict of interest policy.

The IRS's solicitation of input from the tax exempt sector on the Form 990 redesign did not end with the release of the new form for tax year 2008, which had been designed with substantial input from the charitable community. Indeed, as the IRS has continued working to improve the Form 990, the agency has continued to seek outside input. During a public comment period last summer on several issues of concern that had come to the attention of the agency, Independent Sector conducted an online forum to gather input from exempt organizations, and we ultimately submitted a number of specific recommendations to the IRS, including:

- Revising Part VIII of the Form 990 to better capture the full extent of government revenue received by nonprofit organizations by clarifying that government pay-for-service contracts also qualify as government contributions, and by including lines to record revenue received from Medicaid and Medicare payments;
- Adding lines to the Form 990 to inquire whether audited financial statements are made available to the public, and whether the audit includes an unqualified, qualified, adverse, or disclaimer of opinion; and
- Expanding mandatory electronic filing of the Form 990 to include more organizations.

With respect to the last recommendation, currently only about 30 percent of charitable organizations take advantage of the option to file the Form 990 electronically. While we support expanding the scope of organizations that are required to file electronically, we also believe that more can and should be done to encourage electronic filing. To that end, a group of charitable organizations, led by the National Center for Charitable Statistics at the Urban Institute and joined by Independent Sector, has initiated an effort to better understand and overcome the barriers to filing electronically, and to look for ways to encourage or incentivize additional electronic filing. We believe that increased electronic filing will improve the quality and accuracy of the data available to the public and for IRS and state regulatory purposes. This will further promote accountability and transparency by exempt organizations, and in the long run save donors, nonprofits and the government time and money.

We also see great value in encouraging the IRS to continue to review Form 990 requirements to determine whether particular items are necessary and add value, and look forward to similar initiatives with regard to the Form 990PF, which private foundations must file.

As a publicly accessible document, the Form 990 has become an increasingly important tool for volunteers and donors to determine the accountability and transparency of charitable organizations they may wish to support. Indeed, the form is also used by organizations that assess and rank public charities based on their governance policies, stewardship of assets and ethical practices. It is therefore not surprising that we are keenly interested in not only ensuring that the form collects the most useful information possible, but also that the process for compliance by exempt organizations and subsequent use of collected data by the government and the American public is as effective and efficient as possible.

The charitable sector's deep commitment to accountability, transparency and good governance stems from an understanding that doing so enhances our effectiveness and ultimately improves our ability to better serve individuals, families and communities. In that spirit, Independent Sector, in partnership with GuideStar and BBB Wise Giving Alliance, has led the development of Charting Impact, an important tool that encourages nonprofit organizations to engage in reflection, learning, and communication about what matters the most – results.

The Current Environment: Government Oversight of Exempt Organization Governance

The IRS has already begun to use data from the revised Form 990 to develop risk models and guide the development of its annual work plans. One example that may be of particular interest to the Subcommittee is a recent effort to test the proposition that good governance leads to better tax law compliance. The IRS designed a "governance check sheet" that reflects the 26 governance questions on the Form 990. According to IRS officials, this check sheet has been completed by IRS agents at the end of every 501(c)(3) public charity examination since October 2009 -- more than 1,300 exams.

At the fifth annual *Issues in Nonprofit Governance* conference, held last month and cosponsored by Independent Sector, the IRS, and Georgetown University, IRS Exempt Organizations Division Director Lois Lerner reported that a preliminary analysis of the data shows a statistically significant positive correlation between a number of governance practices and tax compliance. Specifically, they reported finding that tax compliance is higher among organizations that:

- Have a written mission statement;
- Always use comparability data when making compensation decisions;
- Have procedures in place for the proper use of charitable assets; and
- Distribute their Form 990 for review by the entire board of directors prior to filing.

Conversely, the analysis showed that organizations in which control is concentrated in one individual or a small, select group of individuals are less likely to be compliant. The IRS also found no correlation between tax compliance and certain other governance practices, including the adoption of conflict of interest policies or whether voting board members have a family and/or outside business relationship with any other director, officer, trustee or key employee of the organization. (It is important to note that while these specific practices may not have been found to impact an organization's tax compliance, they are still vital governance tools that promote greater transparency, accountability and ethical conduct, and we continue to urge their adoption by charitable exempt organizations.)

Lois Lerner further reported that the IRS intends to verify these initial findings with a statistically representative sample of exempt organizations, which will provide a better understanding of the most useful governance questions to include on the Form 990, while also supporting continued compliance by exempt organizations.

The Current Environment: Sector Commitment to Good Governance

The majority of America's 1.3 million charitable organizations are, and always have been, responsible, ethical and accountable in the conduct of their programs and the management of their assets.[12] The public entrusted us with more than $290 billion in direct charitable contributions in

[12] In a study of malfeasance by charitable fiduciaries, it was found that between 1995 and 2002, fiduciaries at only 152 organizations – out of a possible 1.4 million – were accused of civil or criminal wrongdoing. Marion R. Fremont-Smith and Andras Kosaras, *Wrongdoing by Officers and Directors Charities: A Survey by Press Reports, 1995-2002*

2010,[13] with individuals giving over $234 billion while the nation's private foundations and corporate giving programs provided $56 billion to support charitable endeavors.[14]

We are always mindful of the need to earn and protect the public trust, and to that end, the Panel on the Nonprofit Sector also issued *The Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations*, which outlined 33 principles for self-regulation, grouped into four categories:

- Legal compliance and public disclosure;
- Effective governance;
- Strong financial oversight; and
- Responsible fundraising practices.

To date, more than 184,000 copies of the Principles have been downloaded from the Independent Sector website by charitable organizations and the experts who advise them, and in 2011, Independent Sector launched an online Resource Center for Good Governance and Ethical Practice. Built around the Principles, our online resource center includes a comprehensive collection of tools for charitable and philanthropic organizations to help them enhance the accountability and transparency of their operations and ensure that they operate ethically.

Nonprofit charitable organizations have used the Principles to guide their strategic planning, develop key internal governance policies, institute new procedures, adjust board roles and responsibilities, and hire additional staff. In a recent Independent Sector survey of organizations who reported using the Principles, many noted their value as a tool to engage and educate board members on matters of compliance and transparency, thereby instilling confidence in and commitment to the organization's operations.

We have also learned that nonprofit organizations are using the Principles to develop and instill key core values throughout their organizations and associated members. The Y, for example, has developed for its national network of 20,000 full-time employees and 500,000 volunteers five best practices, focused on the philanthropic and strategic leadership of the board, strengthening board structure and composition, evaluating board effectiveness, meeting regulatory and legal compliance standards, and providing strong financial oversight. Similarly, the Land Trust Alliance has used the Principles to establish standards and an accreditation program for its 1,700 member affiliates.

Taken together, the actions outlined throughout my testimony – legislative, regulatory and voluntary – have strengthened governance and improved the oversight of exempt organizations. And perhaps most importantly they have helped our sector to maintain the public trust. Indeed, at a time when public trust in government and for-profit institutions has reached an all-time low, among people who give to and volunteer in the nonprofit sector – people who should know best

[13] The Center on Philanthropy at Indiana University, Giving USA 2011: The Annual Report on Philanthropy for the Year 2010, Giving USA Foundation, 2011. http://www.givingusareports.org/free.php
[14] Ibid

- the perception that the sector is honest and ethical increased seven percentage points between 2006 and 2011.[15]

The progress we have seen, and the resulting continued public support for our sector, reflects a deep mutual commitment – on the part of Congress, the IRS, state charity oversight officials, and charitable nonprofit organizations – to accountability, transparency, and good governance. The progress also underscores our collective determination to preserve an environment in which lawful, ethical, and accountable nonprofit organizations can continue to serve and enrich our communities.

As the Subcommittee works to provide oversight of America's tax-exempt organizations, we look forward to an open dialogue with you, and also to serving as a resource for the Members and staff of the Subcommittee. We will also continue working to educate lawmakers and their staff about the contributions nonprofit organizations make to communities every day, and the impact of proposed policies on our ability to continue making those contributions.

Mr. Boustany and Mr. Lewis, I once again thank you for the opportunity to share these perspectives with you today, and I look forward to answering any questions the Subcommittee may have.

[15] Harris Interactive, Donor Pulse poll, 2011.

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Chairman BOUSTANY. Ms. DeStefano, you may proceed.

STATEMENT OF JOANNE M. DESTEFANO, VICE PRESIDENT FOR FINANCE AND CHIEF FINANCIAL OFFICER, CORNELL UNIVERSITY, TESTIFYING ON BEHALF OF THE NATIONAL ASSOCIATION OF COLLEGE AND UNIVERSITY BUSINESS OFFICERS, ITHACA, NY

Ms. DESTEFANO. Thank you, Mr. Chairman, Ranking Member Lewis, Congressman Reed, and Members of the Subcommittee, thank you for the opportunity to testify today. As already mentioned, my name is Joanne DeStefano, and I am the vice president for finance and chief financial officer at Cornell University.

Today I am testifying on behalf of the National Association of College and University Business Officers, known as NACUBO, which represents more than 2,100 public and private nonprofit colleges and universities.

NACUBO's mission is to promote sound administrative and financial management at institutions of higher education. Cornell University is among the top research universities in the world with nearly $3 billion in annual revenue and expenses.

But today I am here to represent my colleagues at institutions across the country who are responsible for ensuring compliance with Federal Tax Code regulations and interpretations.

I want to stress to you three points today. First, many if not most institutions have long had institutional policies and practices in place reflecting a commitment to stewardship, accountability, and the highest standard of compliance with Federal and State laws and regulations.

Second, both public and private institutions had well established, sound, and effective governing structures prior to the IRS linking good governance to strong tax compliance.

Finally, although sometimes less visible to the public and to students and families, compliance with tax and other Federal rules, regulations, and requirements by institutions is a factor in our cost for education.

Cornell received the compliance survey and just completed a 2-year audit. We closed the audit in March of 2012 and had no findings on our 990 return and just one immaterial adjustment to our net operating loss carry forward on our 990–T.

I believe at Cornell we have two of the Nation's best tax experts in house, and we have a growing tax compliance office. However, as the requirements for reporting and compliance are ever more complex, the university has engaged the services of an external auditor to review and sign both the Form 990 and the Form 990–T, even though these forms are completed internally. The costs are in addition to managing our in-house expertise.

Many large institutions like Cornell are organized similarly. The IRS is requiring not-for-profit organizations to report more and more information on the 990–T. NACUBO has had a history of working with the IRS to ensure its efforts add value and increase understanding, rather than merely increasing administrative costs and creating confusion.

With that in mind, I would like to raise a new concern with Form 990 regarding the (k)(1). This is a new requirement to report income and expenses and balance-sheet items related to partnership investments based on schedule (k)(1) information. Historically, partnership information on the Form 990 was reported consistent with all other financial data based on the organization's books and records. This new requirement will create a number of inconsistencies and add substantially to administrative burden. The IRS has even recognized the concerns and actually took a step back for fiscal year 2011 and allowed the reporting to be voluntary. We strongly encourage the IRS to eliminate this proposed requirement that income on the 990 be reported based on (k)(1)s.

In conclusion, as stewards of Federal education, research, and student aid funding, as large employers, as significant operators of massive physical plant operations, and as home to our Nation's college students, institutions of higher education take very seriously their approach to compliance with a host of Federal rules and regulations, including those by the IRS. We understand the privilege afforded by Congress for tax-exempt entities. We understand and commend the objective of transparency to enhance information available to the public. We urge the Congress, the IRS, and all regulatory bodies to understand that all their respective and many times redundant requirements become a cost of delivery of services. In our case, it is the cost of education.

Ultimately we hope the IRS uses all of the information it has garnered as part of the compliance project to continue to explore smart, sensible, and valuable approaches to streamlining reporting and requirements. Thank you again for my first opportunity to be a voice for all of the colleges and universities at this hearing today.

Chairman BOUSTANY. Thank you Ms. DeStefano.

[The prepared statement of Ms. DeStefano follows:]

TESTIMONY OF JOANNE M. DESTEFANO
VICE PRESIDENT FOR FINANCE AND CHIEF FINANCIAL OFFICER
CORNELL UNIVERSITY

ON BEHALF OF THE NATIONAL ASSOCIATION OF COLLEGE AND UNIVERSITY BUSINESS OFFICERS

BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
HOUSE WAYS AND MEANS COMMITTEE
UNITED STATES CONGRESS
MAY 16, 2012

IN REGARD TO OPERATIONS AND OVERSIGHT OF TAX-EXEMPT ORGANIZATIONS

Chairman Boustany, Ranking Member Lewis, and members of the Subcommittee, thank you for the opportunity to testify today on the oversight and operations of tax-exempt organizations. As Vice President for Finance and Chief Financial Officer at Cornell University, I am here to present the views of public and private nonprofit colleges and universities on behalf of the National Association of College and University Business Officers (NACUBO).

NACUBO, a nonprofit professional organization, represents more than 2,100 chief financial officers and nonprofit institutions of higher education and was established in 1962 to promote sound financial management in higher education. NACUBO, for 50 years, has been providing its members and others information and technical assistance in the field of higher education management and financial administration.

Cornell University is among the top research universities in the world. based on research expenditures, faculty quality, and reputation. It is located in Ithaca, N.Y., with campuses or programs in New York City, including Weill Cornell Medical College and Cornell NYCTech, home of the Technion-Cornell Innovation Institute; Geneva, N.Y.; Appledore Island, Maine; France; England; Italy; Singapore; India; China; Tanzania; Qatar and elsewhere, is the largest and most comprehensive school in the Ivy League and is the land-grant university of the State of New York. Founded in 1865, it is composed of 10 privately endowed and four state contract colleges, including seven undergraduate colleges and seven graduate and professional units. Our four contract colleges are units of the State University of New York (SUNY). Enrollment is approximately 20,000, with students from every state and more than 120 countries studying under an internationally renowned faculty. Forty Nobel Prize winners have been affiliated with Cornell University as alumni or faculty members, and three Nobel laureates currently are on the faculty, in chemistry and physics.

THE AUDIT EXPERIENCE

Cornell is a large research university with nearly $3 billion in operating revenues and expenses during the last fiscal year. Cornell received the Internal Revenue Service (IRS) compliance survey for colleges and universities and completed and submitted the 33-page questionnaire in February 2009. In the fall of 2010, the IRS notified us that they would be auditing our Forms 990 and 990 T for the fiscal year that ended June 30, 2008. The initial conference with the IRS team also occurred in the fall of 2010. During the audit, our primary IRS contacts included the overall manger of higher education audits, two on site auditors, a computer specialist, and a valuation specialist. We closed the audit in March 2012.

The IRS audit of the University's Forms 990 and 990 T was in process for well over two years and absorbed significant staff time; each information request was complex and often required engagement by multiple staff members and documentation from numerous offices across the university.

The primary focus of the IRS audit was to ensure that all necessary information was comprehensively and completely reported on the 990. During the audit, Cornell provided CDs to the IRS computer audit specialist containing enormous data files with every transaction for the fiscal year under audit. The computer audit specialist worked with the staff of the University Controller and the IRS auditors to ensure that the 990 as filed was complete: the data were reconciled to our audited financial statements and our 990. The computer audit specialists also used these files to perform some additional data mining exercises.

The approach of requiring 100 percent of our transaction detail and using computer analysis and key questions and reconciliations was time consuming, but Cornell found it to be a strong and commendable audit step on the part of the IRS. In reviewing our 990, both parties were confident the audit examined the available universe of information.

Cornell also provided extensive documentation in response to at least 50 separate information documentation requests (IDRs). This included:

- Documentation in support of governance (e.g. board minutes and copies of formal policies regarding ethics, organization of subsidiaries).
- Documentation in support of compensation (e.g. board minutes, benchmarking studies and advisory information from outside consulting firms).
- Documentation in support of Unrelated Business Income (UBI) as reported on 990 T—including review of well over 100 K-1s from investments in Cornell's endowment that generate UBI and are reported on 990 T.
- A walk through campus and other document requests to evaluate whether there were other "business related activities not reported." The IRS concluded there were none.

The IRS undoubtedly has a better understanding of higher education after undertaking the Colleges and Universities Compliance Project. NACUBO expects that the responses to the questionnaire, the subsequent audits of colleges and universities, and the final report from IRS will reflect that:

- Many colleges and universities have long had institutional policies and practices in place reflecting a commitment to stewardship, accountability and the highest standard of compliance with federal and state laws and regulations.

- Institutions of higher education are focused on teaching, research, and community service.

- Both private and public colleges and universities had well-established, sound and effective governing structures prior to IRS linking good governance with strong tax compliance and introducing governance-related questions to the Form 990.

- Although sometimes less visible to the public and to students and families, compliance with tax and other federal rules, regulations, and requirements by institutions is a part of the cost of a college education.

OVERSIGHT AND COMPLIANCE

Speaking on behalf of college and university business officers, our sector has markedly increased our internal efforts on tax compliance over the last 20 years. Beginning in the early 1990s, we began to see the appointment of campus tax directors at large research universities. Now it is not unusual for a large institution like Cornell to require a tax compliance department, with staff members trained to stay abreast of tax compliance requirements.

Cornell's approach throughout the 1990s was to ensure compliance with sufficient staffing and appropriate experience and on-going training. Cornell established a dedicated tax compliance office in 1993 and staffed that office with a Certified Public Accountant (CPA) who had over ten years' experience exclusively in tax administration and compliance. But as the requirements for reporting and compliance are ever changing and ever more complex, the University has also incurred additional costs and burden by engaging the services of an external auditor – a major CPA firm – to review and sign both the Form 990 and Form 990-T—though most of these Forms are "prepared" internally. The costs of engaging an external accounting firm is in addition to the costs of maintaining in-house expertise.

Cornell also seeks to be a voice within higher education to encourage the IRS to develop effective approaches to meet the needs of the Service, the public, and higher education in a reasonable and cost effective manner. We respond, most often as a member of a larger professional group like NACUBO, to the IRS' requests for responses to their proposals.

FORM 990

The IRS is requiring universities and other non-profit organizations to report more and more information. In addition to recent reforms that dramatically expanded the core form, exempt organizations are required to file 16 schedules to disclose a multitude of information about governance, financial information, compensation information, lobbying, fundraising, foreign operations, tax-exempt borrowing, and more. NACUBO submitted comprehensive comments on the 990 redesign in 2007, with the goal of working with the IRS to ensure that its efforts add value and increase understanding, rather than merely increasing administrative costs and creating confusion. With that objective in mind, I would like to raise a new concern with Form 990 regarding Schedule K-1.

In January of 2012, the IRS introduced a new requirement to report income, expenses, and balance sheet items related to partnership investments based on Schedule K-1 information. Historically, partnership information on the Form 990 was reported consistent with all other financial data based on an organization's books and records. Shifting to K-1-based reporting of partnership information will likely create a number of inconsistencies in Form 990 reporting of financial information. It most certainly will add substantial administrative burden for many colleges and universities, particularly institutions that receive a large number of Schedules K-1 related to partnership investments.

In response to comments and issues raised by the reporting community, this March the Service took a step back and announced that the requirement will not be mandatory, but optional for tax year 2011. We strongly encourage the IRS to eliminate the proposed requirement that income on the 990 be reported based on K-1s for the following reasons:

- The 990 is an information-based return based on our books and records.
- The K-1 is a tax-based reporting form.
- The K-1 information is already reported on the Form 990-T if that K-1 generates unrelated business income.
- The burden of reporting income on our 990 using a method separate and apart from our books and records is excessively burdensome.

CONCLUSION

As stewards of federal education, research, and student aid funding; as large employers; as significant operators of, in some cases, massive physical plant operations; and as home to our nation's college students, institutions of higher education take very seriously their approach to compliance with a host of federal rules and regulations, including those issued by the IRS. Ultimately, we hope the IRS uses all of the information it has garnered as part of the compliance project to continue to explore valuable and sensible approaches to streamlining reporting requirements.

Again, I thank you for calling this hearing. I would be pleased to answer any questions members of the Subcommittee may have.

Chairman BOUSTANY. Mr. Regier, you may proceed.

STATEMENT OF MICHAEL REGIER, SENIOR VICE PRESIDENT OF LEGAL AND CORPORATE AFFAIRS, VHA INC., WASHINGTON, D.C.

Mr. REGIER. Good morning Chairman Boustany, Ranking Member Lewis, and Members of the Committee. I am Michael Regier and I am pleased to be here on behalf of VHA, a national network of more than 1,400 not-for-profit hospitals and more than 23,000 nonacute health-care organizations. Based in Irving, Texas, we at VHA exist to assure the success of nonprofit health care, and we do this through 47 regional offices—through 15 regional offices that cover 47 States and the District of Columbia.

This morning I wanted to speak to you primarily about two topics: the new requirements that are applicable to nonprofit hospitals under the Affordable Care Act, and then what we at VHA believe matters most to tax-exempt hospitals in the context of more comprehensive tax reform.

As I am sure you know, the Affordable Care Act imposed new statutory requirements that have to be met by all hospitals that seek to obtain or maintain income tax exemption under section 501(c)(3). These requirements are in addition to and not in lieu of the existing requirements already applicable to those organizations.

We recognize the significant increase in the scope of responsibilities assigned to the IRS under the Affordable Care Act and we respect the good work the IRS has done to improve oversight of our Nation's tax-exempt organizations. However, during the more than 2 years since the Affordable Care Act was signed, the IRS has issued various forms of informal guidance and has revised the Form 990 annual information return filed by tax-exempt organizations, but has not yet issued any proposed or final regulations to implement most of the new requirements that are already applicable to tax-exempt hospitals and health systems.

Along with many other stakeholders VHA has worked with the IRS to provide feedback on the informal guidance that has been issued so far and to express our concerns about the potential compliance burdens associated with these new requirements, as well as how they will eventually be implemented and enforced.

And as an example just of the burdensome nature, I brought with me this morning the blank Form 990 with the schedules that must be completed and the instructions every year by tax-exempt hospitals. This is the blank form and instructions. In particular, we have expressed some serious concerns about the way the revised Form 990 Schedule H was issued in February 2011, which we and many other organizations saw as supplanting the ordinary notice and comment rulemaking process.

We also expressed our reservations about the overly prescriptive nature of the more recent draft IRS guidance that relates to the community health needs assessment. We expect that hospitals will have a number of challenges complying with these new requirements, especially given the increasing financial challenges that they are facing. Now more than ever before, we at VHA believe that Congress should ensure that hospitals can direct their limited resources to actually meeting their community's most significant health care needs rather than spending them to document the process that they used to identify those needs.

We support the goals of transparency and accountability, VHA supports the efforts to make the Tax Code fairer, simpler and more efficient, and particularly those provisions that apply to our Nation's nonprofit health-care organizations.

And as the Ways and Means Committee continues its effort toward comprehensive tax reform, we urge the committee to avoid any action that would jeopardize the followings three key benefits: first, the income tax exemption for charitable hospitals; second, tax-exempt financing for hospital facilities; and third, the deductibility of charitable contributions and bequests for hospital donors.

Nonprofit hospitals and health systems need all three of these key benefits to assure that they can serve their communities well, whether that is through charity care or other financial assistance on behalf of the uninsured or underinsured, through subsidized health services, through community health improvement services, through community building services and activities, or through research and education.

Every day in communities throughout the United States, not-for-profit hospitals and health systems provide essential services compassionately and efficiently. Their work to further their charitable missions significantly contributes to the public good and lessens the burdens on government. In view of the expected cuts to Medicare funding under both the Affordable Care Act and the Budget Control Act and in light of the great financial demands that face the many State Medicaid programs, nonprofit community hospitals and health care organizations are going to be challenged to do more than they have ever had to do before to maintain access to quality health care for all Americans.

We have long encouraged our members to take their community benefit obligations seriously and will be working with our hospitals to facilitate their compliance. As we do so, however, we will continue working to assure that the implementation of the new requirements is not unduly burdensome or overly prescriptive and does not go beyond congressional intent. We look forward to working with the Oversight Subcommittee as well as with the IRS to meet these goals. Thank you.

Chairman BOUSTANY. Thank you Mr. Regier.

[The prepared statement of Mr. Regier follows:]

STATEMENT OF VHA INC.

OVERSIGHT SUBCOMMITTEE OF THE COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

IN CONNECTION WITH THE HEARING ON

"TAX-EXEMPT ORGANIZATIONS: OPERATIONS AND IRS OVERSIGHT"
May 16, 2012

Submitted by Michael J. Regier, Senior Vice President of Legal and Corporate Affairs
VHA Inc.
220 Las Colinas Blvd. East
Irving, Texas 75039

VHA Inc. (formerly Voluntary Hospitals of America) appreciates the opportunity to deliver this testimony on the current operations and challenges of tax-exempt community hospitals, the impact of the new statutory requirements for hospital tax exemption enacted as part of the Accountable Care Act, and certain concerns and policy priorities of nonprofit hospitals regarding comprehensive tax reform

My name is Michael Regier, and I am senior vice president of legal and corporate affairs, general counsel and compliance officer for VHA Inc. In this position, I am also responsible for overseeing VHA's public policy office. Prior to joining VHA in 2007, I served for twelve years as senior vice president and general counsel of the Seton Healthcare Family, a non-profit hospital system based in Austin, Texas.

Founded in 1977, VHA is dedicated to the success of nonprofit, community-based health care. VHA is a national alliance of over 1,400 not-for-profit hospitals and more than 23,000 non-acute health care organizations. VHA helps its members deliver safe, effective and cost-efficient health care through both national and local support. VHA has 15 regional offices covering 47 states, as well as a public policy office in Washington, D.C.

For many years, VHA has undertaken a leadership role in the field of community benefit for not-for-profit hospitals. VHA supports its members in their task of assessing and meeting community health needs by providing tools, best practices and other resources. The Guide for Planning and Reporting Community Benefit, developed through VHA's longstanding collaboration with the Catholic Health Association (CHA), has become an industry standard resource for non-profit hospitals and health systems. Most recently, VHA and CHA have developed a new community benefit planning resource entitled Assessing and Addressing Community Health Needs. VHA has also provided its members with resources and best practices in the areas of corporate governance and whole hospital joint ventures.

Introduction

Under federal tax law prior to its amendment by the Affordable Care Act, tax exemption for nonprofit community hospitals was governed by a handful of Internal Revenue Service (IRS) administrative rulings and judicial decisions. In the context of enacting a comprehensive health care reform bill, Congress determined that specific statutory rules and more oversight by both Congress and the IRS were appropriate.

Prior Law Governing Hospital Tax Exemption

Since 1969, the IRS used the "community benefit" standard for determining whether a hospital is charitable.[1] In Revenue Ruling 69-545, the IRS ruled that community benefit included:

- Maintaining an emergency room open to all persons regardless of ability to pay;
- Having an independent board of trustees composed of representatives of the community;
- Operating with an open medical staff policy, with privileges available to all qualifying physicians;
- Providing charity care; and
- Utilizing surplus funds to improve the quality of patient care, to expand facilities, and to advance medical training, education and research.[2]

In 2009, the IRS began requiring hospitals to submit detailed information on their community benefit activities and expenditures on their annual information returns filed with the IRS.[3] VHA, working together with other hospital associations and industry groups, advised the IRS on the development of the new Schedule H (Hospitals).

Overview of New Tax-Exempt Hospital Provisions

The provisions enacted as part of the Affordable Care Act include the following:

- Section 9007(a) of the Act added new statutory requirements that must be met by all hospitals seeking exemption from federal income tax and other tax benefits as 501(c)(3) organizations.[4] These requirements are now contained in new Internal Revenue Code ("Code") Section 501(r).
- Section 9007(b) added a new penalty excise tax (new Code Section 4959) to help enforce the new requirements.
- Section 9007(c) mandated IRS review of each 501(c)(3) hospital and its community benefit activities at least once every three years.

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[1] *See* Rev. Rul. 69-545. 1969-2 C.B. 117 and the Restatement (Second) Trusts (1959). *See generally* Bruce R. Hopkins, The Law of Tax-Exempt Organizations, sec. 6.3 (discussing various forms of health-care providers that may qualify for exemption under section 501(c)(3)).
[2] Rev. Rul. 69-545.
[3] *See* IRS Form 990, Schedule H (Hospitals).
[4] Organizations qualifying for federal income tax exemption pursuant to Code Section 501(c)(3) are eligible to receive tax deductible contributions, have access to tax-exempt financing through State and local governments, and are generally exempt from State and local taxes.

- Section 9007(d) imposed new reporting and disclosure requirements on 501(c)(3) hospitals filing the annual information return known as the IRS Form 990.

The requirements are entitled, "Additional Requirements for Section 501(c)(3) Hospitals," and the legislative history makes it clear that the new requirements are in addition to, and not in lieu of, the requirements otherwise applicable to 501(c)(3) organizations. As detailed below, new Code Section 501(r) imposes the following new requirements that a hospital must satisfy to obtain or maintain its status as a 501(c)(3) organization:

- prepare and widely publicize a community health needs assessment ("CHNA") every three years, and adopt an implementation strategy to meet the health needs in the CHNA

- adopt, implement and widely publicize a financial assistance policy (providing for free or discounted medical care for those who qualify) as well as a written policy for the provision of emergency medical care

- abide by a limitation on charges for medical care when such care is provided to those qualifying for financial assistance

- refrain from engaging in "extraordinary" collection efforts before making reasonable attempts to determine whether a patient qualifies for financial assistance.

The new requirements are generally effective for taxable years beginning after March 23, 2010. Thus, for a calendar year hospital, the new requirements became effective on January 1, 2011. However, the new CHNA requirement is not mandatory until taxable years beginning two years after March 23, 2010. Thus, for a calendar year hospital, the CHNA requirement must be fulfilled in the taxable year starting on January 1, 2013.

IRS Guidance Related to the new Statutory Requirements under Section 501(r)

Since Section 501(r) was enacted in 2010, the IRS has issued no proposed or final regulations, but it has issued various forms of informal guidance (specifically, Notice 2010-39, Notice 2011-52, Announcement 2011-37 and Notice 2012-4). It has also amended the IRS Form 990 Schedule H to incorporate over 20 new questions with over 60 different subparts. These new questions are principally found in Part V, Section B (Facility Policies and Practices) and must be filled out separately by each hospital facility that is subject to the new statutory requirements. While most of these questions are designed to measure hospital compliance with the new requirements, the IRS has stated that some of the questions are merely informational in nature.

In **Notice 2010-39**, 2010-39 IRB 24 (June 14, 2010), the IRS described each of the new tax-exempt hospital requirements and solicited public comment on how they should be interpreted. Other than setting forth the statute and legislative history relevant to each requirement, Notice 2010-39 did not provide guidance to the hospital community on the new requirements.

VHA, like all of the major hospital groups and other stakeholders, submitted comments to the IRS on July 21, 2010. VHA's comments on Notice 2010-39 are available on its website at:
https://www.vha.com/AboutVHA/PublicPolicy/Advocacy/Advocacy%20Letters/2010/IRS_VHA_Comment_Ltr_PPACA_Provisions_07_21_2010.pdf

Release of Revised Schedule H. After soliciting initial comments from the hospital community on the new requirements as well as conducting several meetings with hospital representatives in 2010 and early 2011, the IRS on February 23, 2011, released a substantially revised version of the Form 990 Schedule H along with revised instructions to Schedule H. Much to the surprise of the hospital community, the revised Schedule H appeared to incorporate or predetermine many of the issues relating to the new requirements on which the IRS had sought public comment through Notice 2010-39. Several hospital membership organizations and associations protested that the numerous detailed revisions to the Schedule H appeared to supplant the process of issuing regulatory guidance pursuant to notice and public comment standards. Initially, the IRS responded that "nothing in it [the revised Schedule H] depends on the regulatory process that we are currently engaged in with the community..." See "Schedule H Implements Tax-Exempt Hospital Guidance Before Rules are Out, Some Say," 54 BNA Daily Tax Report G-7 (March 21, 2011) (quoting IRS Tax Exempt and Government Entities Commissioner Sarah Hall Ingram).

Announcement 2011-37, 2011 IRB 27 (July 5, 2011). After the tax-exempt hospital community continued to press its specific concerns about the new Schedule H, the IRS announced that it "decided to make the entire Part V, Section B [of the revised Schedule H] optional for the 2010 tax year to give the hospital community more time to familiarize itself with the types of information the IRS will be collecting related to compliance with section 9007 [of the Accountable Care Act]...and to address any ambiguities arising from the extensive revisions of the form and instructions." The IRS also stated that it "continues to invite comments on how to improve the clarity and reduce the burden of reporting the information related to these additional requirements on the Form 990 and Schedule H." An IRS Memorandum attached to Announcement 2011-37 stated that "the Service does not intend the new Schedule H to serve as a substitute for any regulations or guidance that may be necessary to carry out the provisions of Section 501(r) " It also contended that "many of the questions asked in Section V and responses elicited are *informational* in nature, and thus a "negative" answer *should not* be interpreted as indicating non-compliance with specific requirements under Section 501(r)."

Following the release of the revised Schedule H, VHA continued to work actively with other hospital groups, such as the American Hospital Association (AHA) and the Healthcare Financial Management Association (HFMA) to identify ways in which the Schedule H could be revised to eliminate redundancies and reduce burdensome paperwork. VHA, AHA and HFMA also identified for the IRS those questions on the revised Schedule H that appeared to reach beyond the scope of the statute or were inconsistent with Section 501(r) and its legislative history. See VHA-AHA-HFMA Joint Letter to IRS Commissioner Sarah Hall Ingram (April 20 2011), posted at http://www.aha.org/advocacy-issues/letter/2011/110420-cl-schedh.pdf. Subsequently, VHA joined AHA and HFMA in developing line by line comments on the Schedule H. See VHA-AHA-HFMA Joint Letter to IRS Commissioner Sarah Hall Ingram (August 24, 2011), posted at http://www.aha.org/advocacy-issues/letter/2011/110824-let-aha-hfma-vha-snall.pdf.

Notice 2011-52, 2011 IRB 30 (July 25, 2011) set forth in significant detail the guidance that IRS is considering with respect to the specific requirement that each hospital conduct a community health needs assessment (CHNA) at least once every three years. While VHA has consistently urged its members to conduct regular assessments of community health needs as a critical component of community benefit planning, VHA expressed serious concerns about the overly prescriptive nature of the IRS guidance relating to CHNAs. It lodged particular objection to the many procedural requirements described in the Notice 2011-52, some of which IRS has already incorporated into the questions in Part V, B of the revised Schedule H. VHA's articulated concerns about IRS's proposed approach include the following:

- Requiring each hospital facility in a multi-hospital system to issue a separate written report on its CHNA, as opposed to allowing the system to issue a consolidated report.
- Imposing excessively detailed mandates regarding consultation with public health agencies and representatives of specific populations within a community (i.e., populations with chronic health needs).
- Imposing excessive CHNA documentation requirements, particularly those focused on the process of conducting the CHNA (e.g., describe the process and methods used to conduct the assessment (including sources and dates), specify how and when the hospital consulted with community leaders (including specific names and titles of individuals consulted, and whether such consultation involved meetings, focus groups, interviews, surveys or written correspondence), and specify "information gaps" that may have affected the hospital's ability to assess community health needs).
- Requiring each hospital to attach its most recently adopted CHNA implementation strategy to its Form 990 (as opposed to allowing the hospital the option of either attaching the strategy or reporting how the hospital is addressing the health needs identified through its CHNA--as the statute requires).

Hospital challenges in complying with the new requirements

VHA expects that hospitals will have a number of challenges complying with the new requirements, particularly in light of current health insurance trends and reimbursement shortfalls. At the same time, VHA believes that Congress needs to make sure that hospitals are able to direct their limited resources toward meeting their communities' most significant health needs as opposed to complying with excessively burdensome paperwork requirements.

Some of the specific areas which VHA has identified as needing further guidance from IRS include the following:

- Applicability of the statutory requirements to hospital joint ventures (including those not operated as charitable hospitals generating exempt income)

- Calculating permissible charges in compliance with the limitation in Code Section 501(r)(5) on amounts hospitals may charge for emergency or other medically necessary treatment provided to individuals who qualify for financial assistance (i.e., did Congress intend this requirement to apply and be calculated on a procedure-by-procedure basis or may hospitals calculate an average effective discount rate received from each commercial insurance company across all covered procedures and services?)

- Whether hospital reporting of delinquent patient accounts to credit agencies is to be considered an "extraordinary collection" measure

- What constitutes "reasonable efforts" to determine whether an individual is eligible for financial assistance

Some of the areas that IRS has already clarified--at least through the informal mechanism of the IRS Schedule H and its Instructions--including the following:

- Defining what type of "hospital facility" is generally required to comply with the new requirements and to report its compliance on the Schedule H

- Describing what is involved in "widely publicizing" the required financial assistance policy

- Clarifying that the "best" commercial rate means the "lowest" rate for purposes of the limitation on charges

- Defining the scope of the mandate to provide emergency medical care without "discrimination"

What matters to tax-exempt hospitals in the context of comprehensive tax reform

VHA supports efforts to make the tax code fairer, simpler and more efficient. We agree with the many members of this Committee who have recognized that the economy loses substantial amounts of productivity each year because of our burdensome tax system. Even tax-exempt organizations are not exempt from having to spend millions of dollars to comply with IRS documentation and filing requirements. These requirements, some of which have not been mandated by Congress, appear to have grown exponentially in recent years. A good example is the redundant and overly prescriptive Schedule H.

Not-for-profit health care organizations play a critical role in community health needs, and more is being asked of them every day because of the growth in our uninsured (or underinsured) populations. Federal tax benefits are important in helping such organizations carry out their missions and meet their needs for capital.

As the Ways & Means Committee continues its efforts toward comprehensive tax reform, it should avoid taking any action that would jeopardize the following core benefits:

-- income tax exemption for charitable hospitals
-- tax-exempt financing for hospital facilities
-- deductibility of charitable contributions and bequests for hospital donors

All three of these are needed by nonprofit hospitals in order to provide the maximum amount of community benefit, including charity care and other financial assistance on behalf of uninsured and low-income persons, subsidized health services, community health improvement services, community building activities, research and education.

The exemption from income tax of charitable and other not-for-profit organizations is longstanding. While most nonprofit hospitals operate on very slim margins and thus have little net income subject to tax, the exemption permits not-for-profit organizations to retain earnings for future capital improvement. It also provides a uniform foundation for many state tax exemptions, including exemption from sales and property taxes.

A second tax provision is the exclusion for tax-exempt bond interest. Charitable organizations like hospitals have significant capital needs and rely on tax-exempt financing to obtain much needed capital. Since not-for-profit hospitals by law cannot raise money by issuing stock to investors, debt and retained earnings are their only sources of capital to make the investments in staff, facilities and technology that are required to deliver the safe, high-quality care their communities need and deserve. While the markets for tax-exempt financing by hospitals are fairly well established at present, many hospitals and other not-for-profit entities would be severely hampered in obtaining debt financing at all if these markets were disrupted through significant changes to the tax treatment of interest paid on tax-exempt bonds.

A third tax provision that directly benefits charitable organizations is the deduction for charitable contributions. In the health care context, both individual and corporate contributions are essential funding sources for medical research and education, capital improvements and community health activities and organizations. The Obama Administration has proposed a reduction in the value of charitable contribution deductions for taxpayers in the 33 and 35 percent brackets. VHA opposes any such a limitation, and believes that it would have a particularly negative impact on significant gifts by individual donors.

Conclusion

Not-for-profit hospitals and health systems provide essential services efficiently and compassionately every day in communities throughout the United States. Their work in further of their charitable missions contributes significantly to the public good and lessens the burdens of government. In view of anticipated cuts in Medicare funding under the Affordable Care Act and the Budget Control Act, and in light of the great financial demands many state Medicaid programs face, nonprofit community hospitals and health care organizations will be challenged to do more than ever before to maintain access to quality health care for all Americans.

In the Affordable Care Act, Congress saw fit to codify some of the specific community benefit obligations of tax-exempt hospitals. VHA has long encouraged its members to take their community benefit obligations seriously, and will now work to facilitate their full compliance with the codified requirements, which include

- Conducting a community health need assessment at least once every three years
- Adopting and publicizing a financial assistance or "charity care" policy
- Limiting hospital charges for medical care payable by individuals qualifying for financial assistance, and
- Refraining from taking "extraordinary" collection actions before making reasonable efforts to determine whether the patient qualifies for financial assistance.

As we work with our members, however, we will also continue our advocacy aimed at assuring that the implementation of these new requirements is not unduly burdensome or overly prescriptive and does not go beyond Congressional intent. In particular, the revised Schedule H--with its confusing mix of compliance inquiries and informational questions--needs to be streamlined and simplified. VHA looks forward to working with the Oversight Subcommittee as well as with the IRS toward this goal.

For further information regarding any of the topics discussed herein, please contact Michael J. Regier, Senior Vice President of Legal and Corporate Affairs, VHA Inc., at (972) 830-6810 or mregier@vha.com or Cidette Perrin, Senior Director Governmental Relations, VHA Inc. at (202) 354-2608 or cperrin@vha.com.

Chairman BOUSTANY. Mr. Hopkins, you may proceed.

STATEMENT OF BRUCE R. HOPKINS, SENIOR PARTNER, POLSINELLI SHUGHART, KANSAS CITY, MO

Mr. HOPKINS. Thank you. And good morning, Mr. Chairman, Ranking Member Lewis, and the other Members of the Subcommittee.

My task as a private practitioner in the exempt organizations area is to spend some time talking with you about the basics of the law in this area and then also identify what I believe to be the current developments in the field.

By my reckoning there are 67 different categories of tax-exempt organizations. Obviously I lack the time to take you through all of those. But what I have done in my prepared remarks is focus first on 501(c)(3) entities, charities, religious organizations, educational organizations, scientific entities, to give you a feel for the detail and the criteria for exemption under each one of these categories.

For example, in the paper I note that under the concept of "charitable," there are 15 different ways that an entity can qualify as a tax-exempt charitable organization. Aside from a 501(c)(3) there are a number of other categories of exempt organizations, as I mentioned, and I highlighted in my paper the ones that I think should be and are a primary concern to you: 501(c)(4) and 501(c)(6). And so I have got some material in there about social welfare organizations, the whole concept of what it means to promote social welfare, what it means to serve a community, and, in the context of business leagues, discuss the rules about operating to promote a common business interest, a line of business, and the rules dealing with not performing particular services for individual persons.

There are plenty of other exempt organizations that could be talked about: political organizations, social clubs, fraternal organizations, labor groups, qualified health insurance issuers. But I wanted to put in the material at least a summary of the law dealing with what I consider to be the main categories.

And then on the last page of my prepared remarks, I have given a simple list of what I believe to be confirmed developments in this area. I don't have time to go down the entire list. But as you can see, items like governance, which you have already heard about, and the Form 990 you have already heard about are at the top of the list. This isn't necessarily a prioritized list, but certainly those two are on the top of any type of list like this. The whole IRS enforcement fees, compliance checks, the whole matter of political campaign activity, particularly the involvement of charitable entities and social welfare organizations in that; the pending regulation projects and other initiatives of the Internal Revenue Service of which there are a lot; and then, of course, the status of tax extenders legislation certainly impacts this field, and the whole matter of tax reform obviously interrelates with the law of tax-exempt organizations as well.

So with that I think I will end my oral remarks and will be happy to take whatever questions the subcommittee might have.

Chairman BOUSTANY. Thank you, Mr. Hopkins.

[The prepared statement of Mr. Hopkins follows:]

U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS

HEARING BEFORE THE
SUBCOMMITTEE ON OVERSIGHT

OPERATIONS AND OVERSIGHT OF TAX-EXEMPT ORGANIZATIONS

Testimony of Bruce R. Hopkins

Tax-Exempt Organizations Law Basics
and Current Developments

May 16, 2012

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TAX-EXEMPT ORGANIZATIONS LAW BASICS AND CURRENT DEVELOPMENTS

Chairman Boustany, Ranking Member Lewis, and other Members of the Subcommittee on Oversight, thank you for this opportunity to testify before you on the law of tax-exempt organizations and current developments in this field. I have been a practitioner in this area for over 42 years. I am counsel to a wide range of tax-exempt organizations, including universities, hospitals, other public charities, private foundations, and associations. This practice includes representation of exempt organizations before the Internal Revenue Service.

I have written several books about nonprofit law, including *The Law of Tax-Exempt Organizations*, now in its Tenth Edition. I write a monthly newsletter about nonprofit law developments, titled *Bruce R. Hopkins' Nonprofit Counsel*.

What follows is an overview of the federal tax law applicable to certain tax-exempt organizations.

CHARITABLE ORGANIZATIONS

The federal tax law definition of a charitable organization contains at least 15 different ways for a nonprofit entity to be charitable. These characteristics, found in the income tax regulations, IRS rulings, and federal and state court opinions, include relieving the poor or distressed or the underprivileged; advancing religion, education, or science; lessening the burdens of government; beautifying and maintaining a community; preserving natural beauty; promoting health, social welfare, environmental conservancy, arts, or patriotism; caring for orphans or animals; promoting, advancing, and sponsoring amateur sports; and maintaining public confidence in the legal system. Those most widely claimed are discussed in the discussion that follows.

The relief of poverty is perhaps the most basic and historically founded form of charitable activity. Originally, it meant largely the distribution of money or goods to the poor. In contemporary times, particularly as government has assumed some of this function, it means more the provision of services. This type of charitable entity might feed the homeless or provide them shelter, operate a counseling center, provide vocational training, supply employment assistance, provide low-income housing, or offer transportation services.

The relief of the distressed is a considerably misunderstood way to be charitable. Too many associate distressed with impoverishment. To be sure, one way to be distressed is to be financially distressed (although one can be only temporarily financially distressed). An individual can, however, be physically or emotionally distressed. The confusion as to the scope of the concept of distressed was, most unfortunately, displayed in the aftermath of the terrorist attacks against the U.S. in 2001, when there was a huge outcry and battle as to who was entitled to relief funds—and pursuant to what criteria. While the law tends to precisely define the term poor, the concept of the term distressed is largely undefined and expansive.

The advancement of religion, as a charitable activity, frequently pertains to collateral activities of churches. For example, charitable organizations of this nature may maintain church buildings, monuments, or cemeteries; distribute religious literature; or supplement salaries. These organizations may conduct programs unique to a particular religion, operate a retreat center, or maintain a religious radio or television station.

The advancement of education, as a charitable activity, includes providing student assistance; advancing knowledge through research; or disseminating knowledge by means of publications, seminars, lectures, and the like. This type of charitable function may be a satellite activity of a particular educational institution, such as a university, library, or museum.

The promotion of health is a separately recognized charitable purpose; in this context, public and mental health are included. This function includes the establishment and maintenance of institutions and organizations such as hospitals, clinics, homes for the aged, and similar treatment or residential centers. Other illustrations of health-providing (or health-promoting) organizations are health maintenance organizations, drug abuse treatment centers, blood banks, hospices, and home health agencies. The advancement of medical and similar knowledge through research, and, generally, the maintenance of conditions conducive to health are included. Classification of an organization as a tax-exempt hospital or a medical research organization is an automatic pathway to avoidance of private foundation status.

The promotion of social welfare is one of the most indefinite categories of charitable endeavors. In the law of trusts, the concept of promotion of social welfare can include such purposes as the promotion of temperance or national security or the erection or maintenance of tombs and monuments. In the federal tax law context, the term embraces activities designed to accomplish charitable purposes, lessen neighborhood tensions, eliminate prejudice and discrimination, defend human and civil rights secured by law, and combat community deterioration and juvenile delinquency.

EDUCATIONAL ORGANIZATIONS

Educational organizations include schools, colleges, universities, libraries, museums, and similar institutions. To be a "formal" educational institution, an organization must have a regularly scheduled curriculum, a regular faculty, and a regularly enrolled body of students in attendance at the place where the educational activities are carried on.

There can be a fine line of distinction between an educational activity and a taxable-business. Sometimes it is difficult to distinguish between an educational undertaking and one that amounts to propagandizing—the zealous endorsement of a particular idea or doctrine in a manner that is not reasonably objective or balanced. It is often impossible (and unnecessary) to differentiate between organizations that are charitable because they advance education and those that are educational.

RELIGIOUS ORGANIZATIONS

Religious organizations are the oldest form of tax-exempt organization. Unlike other areas of the law of tax-exempt organizations, religious organizations defy definition. This is due in large part to the First Amendment to the U.S. Constitution, which bars Congress from making any law that would establish religious organizations or prohibit the free exercise of religion.

There are many kinds of religious organizations; the most common form is referred to as a church (including synagogues and mosques). But, here again, the federal tax law lacks a crisp definition of the word church. The IRS has informally defined a church as an organization that satisfies at least some of the following criteria: a distinct legal existence, a recognized creed and form of worship, a definite and distinct ecclesiastical government, a formal code of doctrine and discipline, a distinct religious history, a membership not associated with any other church or denomination, a complete organization of ordained ministers ministering to their congregations and selected after completing prescribed courses of study, a literature of its own, established places of worship, regular congregations, regular religious services, Sunday schools for the religious instruction of the young, and schools for the preparation of its ministers.

Other types of religious organizations, for tax purposes, include conventions of churches, associations of churches, integrated auxiliaries of churches, religious orders, apostolic groups, missionary organizations, bible and tract societies, and church-run organizations, such as schools, hospitals, orphanages, nursing homes, publishing entities, broadcasting entities, and cemeteries.

SOCIAL WELFARE ORGANIZATIONS

Traditionally, a social welfare organization is one that, in the language of the tax regulations, functions to advance the "common good and general welfare," and seeks "civic betterments and social improvements." This type of organization is expected to engage in activities that benefit the community in its entirety, rather than merely its own membership or other select groups of individuals or organizations.

A contemporary use of the social welfare organization is as an advocacy entity. The term social welfare can be broader than the term charitable (even though, as discussed previously, the concept of charitable includes the promotion of social welfare). Social welfare organizations can engage in an unlimited amount of legislative activity without endangering their tax-exempt status, and they can permissibly engage in some political campaign activity. Consequently, some charitable organizations link up with related social welfare organizations as a means of engaging in more lobbying activities than the charitable organizations are allowed to undertake directly.

Like many other tax-exempt organizations, social welfare entities may not engage in transactions that constitute private inurement and may not operate unrelated businesses as a primary activity. The only type of social welfare organization to which contributions are deductible is a veterans' organization.

BUSINESS LEAGUES

A business league is a group of persons (an association) who have some common business interest; the purpose of the league is to promote that common interest. Its activities (if it is to be tax-exempt) are directed to the improvement of business conditions of one or more lines of business, as distinguished from the performance of particular services for individual persons.

CURRENT DEVELOPMENTS

An inventory of current developments in the law of tax-exempt organizations includes the following.

- IRS involvement in nonprofit governance.
- Implications of the revision of the Form 990.
- IRS compliance checks.
- Charitable organizations' involvement in political activity.
- Import of IRS college and university compliance check.
- IRS look at "self-declarer" exempt organizations.
- IRS processing of applications for recognition of exemption.
- Pending regulation projects (including those pertaining to supporting organizations and donor-advised funds).
- IRS charitable spending initiative.
- Supreme Court decision in health care context.
- Status of tax extenders legislation.
- Implications of pending tax reform.

Chairman BOUSTANY. Clearly the tax-exempt area is a growing and increasingly complex sector of our economy, and that is why we feel it is important to have this oversight hearing as a starting point to get a better understanding of the sector as we contemplate fundamental tax reform. And all of you have raised important questions and concerns.

I want to focus for a moment on the Form 990 specifically. This question is for the entire panel, but I would like to start with Ms. DeStefano and Mr. Regier to address this with regard to universities and hospitals in particular.

The IRS has just completed a revision of the Form 990. It took several years to complete and according to the IRS has been redesigned to enhance transparency, promote tax compliance and minimize the filing burdens. As part of this effort, the form was reorganized and filers were given more opportunities to explain their tax-exempt activities, but were also required to provide more information regarding key issues such as executive compensation and other things.

How is this process working from your perspective? Ms. DeStefano, you can start.

Ms. DESTEFANO. Thank you for the question. We share our 990 before it is filed with our audit committee of our board of trustees. There are approximately 12 members of the audit committee. And I can say 3 or 4 years ago, we would have in-depth conversations about the data and material within the 990. Today the form is so complicated that our committee of our board of trustees do not know where to begin. And I would say we have less than one or two questions on the 990 today than where we were 3 years ago.

Chairman BOUSTANY. Okay. Do you think that the form meets the criteria set forth initially by the IRS?

Ms. DESTEFANO. I think there is too much information. And if you could streamline to the key points, and if executive compensation is an area that Congress feels is very important, keep that.

We have some schedules, if you don't mind, if I could just highlight that we feel are redundant. Schedule F, which relates to foreign activity; Schedule I, which is subcontracts; and Schedule K, which is tax-exempt bonds. They require a tremendous amount of information and we are not exactly sure of the value.

And I would like to point out, if I could zero in on Schedule I, which is the subcontracts. It requires information on grants and other assistance from organizations, governments, and individuals within the U.S. Cornell's response is 20 pages long. And it consists almost entirely of subcontracts through the Federal Government as part of our research enterprise.

OMB already has a single audit act, with OMB A–133 that audits States, local government and not-for-profit organizations. If we could eliminate all of the reporting that already goes through another phase of what is being audited, we estimate this one change would save 40 hours of work preparing our 990 plus 20 pages of reporting data.

Chairman BOUSTANY. Thank you. Mr. Regier.

Mr. REGIER. Mr. Chairman, to go back to the first question, I think our members would say the form does make much more information available. I don't think that they would agree that it promotes efficiency or that it has lightened the filing burden. The form has expanded significantly. That is why we brought it this morning.

I think the experience in most tax-exempt hospitals is very similar to what Ms. DeStefano outlined. This is not a form that, despite your best efforts and expertise inside of your organization, that you really can afford not to engage an outside advisor to help you with, whether that is your outside tax counsel, your outside auditors, or specialized tax consultants.

Chairman BOUSTANY. I thank you. Any other members of the panel want to comment?

Mr. HOPKINS. Mr. Chairman, I think one sentence might sum it up. The Form 990, the new Form 990 has greatly enhanced my law practice.

Chairman BOUSTANY. Others?

Mr. COLINVAUX. Well, I think one little bit of context, which is where we were before the new Form 990. Which was, the IRS was under a lot of pressure to revise the form because the form was seen as very outdated and not providing enough information. So it took years for them to come up with the new form.

I think the other thing that is important to keep in mind is the value of the Form 990 as an enforcement tool. One of the difficulties here is that there is not a lot for the IRS to enforce. And one of the things that—one of the ways that we can keep oversight over organizations is through the disclosure of information which is made public on the 990.

I think one of the problems that is being highlighted here is the too-much-information problem. And I recognize that is a problem. But I also think that it is a problem that the IRS is trying to work out by continuing to revise the form in discussions with stakeholders to find out what the most relevant oversight information is.

And finally, I would say that the complexity of the form is absolutely correct. The instructions are, you could say, monstrous because they are so big. But what is going on here is that the complexity is reflecting the complexity of the sector. The sector is not a simple thing. And so the form is getting more complex as the IRS learns how complex the sector is. So there are a lot of issues at play here.

Ms. AVIV. Just a very quick comment. The Form 990 is the only vehicle through which the public, donors and volunteers, or people seeking jobs can actually find out what is going on in an organization, or quite a lot about it. Now, there may be some parts of it that are too detailed, but this revised form has provided the first opportunity to get a really good picture of the charitable sector. So as we go forward with this, let's be mindful of the benefit of the public being able to see into these organizations as well.

Chairman BOUSTANY. Thank you. Just a follow-up question, Mr. Colinvaux. Obviously this is a very complex and growing sector. Should there be—should we disaggregate to some extent or should the IRS disaggregate in terms of trying to get certain types of information from one sector of the tax-exempt area versus another?

Mr. COLINVAUX. Well, I think that is what is happening. I mean the IRS has been under a lot of pressure in recent years, in part because of the scandals that have happened at organizations. And so I think what the IRS is doing is they are educating themselves and they are saying there are two very big elephants in the room; it is namely the hospitals and big colleges and universities. They take up most of the assets and the revenues of the sector. And so there is disaggregation going on not only in terms of exemption standards passed by Congress but in terms of enforcement, so new compliance initiatives are launched, we look at the hospital sector, they look at the colleges and university sector. So disaggregation is happening and it is happening on the Form 990, as well as more tailored questions, depending on what you do, are surfacing in the 990. So you can show the whole form, but a lot of that form isn't relevant to a lot of organizations.

So, yes, I think the disaggregation is happening. It is one of the facts on the ground, and it is something that policymakers are going to continue to wrestle with.

Chairman BOUSTANY. Anybody else want to comment on that issue? No. Mr. Colinvaux, the Ways and Means Committee, as you know, is currently focused on comprehensive tax reform, and we are definitely reviewing all areas of the code, including provisions that apply to tax-exempt organizations. You have recently looked at the tax-exempt sector over the last 10 years and were on the Joint Committee on Taxation in 2006 when the Pension Protection Act was enacted, which contained many new provisions related to tax-exempt organizations. Are there any lessons from the last few years we should keep in mind when considering tax reform proposals in this area?

Mr. COLINVAUX. Well, one lesson based very much on my experience is to continue conducting hearings such as this, which is I think a really important form of oversight, because it calls the sector together and it reminds the sector that they need to do good and perform a public benefit. So I think this is a very important form of oversight that really does lead to better behavior. So that is one lesson.

Another lesson is—what struck me about the Pension Protection Act was that it was very much focused on correcting abuses. And there are and always will be abuses in any sector. One of the challenges going forward, which was not addressed in 2006, really goes to the role the Federal Government has with respect to (c)(3) organizations. So we can take the anti-abuse path, which is the path that we are on, continue to write rules that go to abuses, or we can start to ask harder questions such as which organization should get which benefits, do we expect certain public benefits to occur from our (c)(3)s? Those are questions that were not really asked in the lead-up—they were asked in the lead-up to 2006 but weren't really answered. So I think those are—the lessons are we still have those questions, maybe.

Chairman BOUSTANY. Thank you. I appreciate that. I am now pleased to yield to the ranking member, Mr. Lewis, for questions.

Mr. LEWIS. Thank you very much Mr. Chairman. And again I would like to thank each member of the panel for being here and for your testimony.

Mr. Hopkins, you are a noted expert on tax-exempt organizations and you have worked in this area for over 42 years. I don't believe you worked there that long. Apparently someone violated the child labor law and some law firm hired you at an early age, but I don't want to get into all of that.

Now, the IRS has fewer than 900 employees to monitor more than 1.8 million organizations. Can you tell the Members of the Committee how you feel the IRS is doing in the oversight of these organizations?

Mr. HOPKINS. Well, Congressman Lewis, I think based on the resources the IRS has, I think the IRS overall is doing a very good job. I have never worked for the IRS so I am not familiar with the internal workings. But based on what I see and certainly based on my years of practice working with the IRS, both on the examination side and working with the IRS with organizations that are applying for recognition of exemption, the IRS I think is doing an excellent job in reviewing entities, screening entities.

I would note that almost every week there are a number of private letter rulings that are issued by the IRS. I review each one of those, and almost all of them are adverse to the nonprofit organizations that are applying. So the IRS is being very aggressive, very active in applying the law and determining which organizations comply and which ones don't. So my impression overall is that the Agency is doing a good job, a very good job actually with the resources that it has.

Mr. LEWIS. Now, I noticed someplace that you provide a monthly newsletter?

Mr. HOPKINS. That is correct.

Mr. LEWIS. Do you get feedback from the private sector?

Mr. HOPKINS. I get a lot of email as a result of some of the things that are mentioned in the newsletter, yes.

Mr. LEWIS. Are people pretty satisfied with what they get from the IRS?

Mr. HOPKINS. Well, I think it depends on what kind of entities you are talking about. I mean, I hear a lot from organizations that are unhappy that they have been audited and/or been denied recognition of exemption. But I think on balance, probably the IRS position was correct. And then, of course, I hear from organizations that are very happy with the situation that they are in. So I think it just depends on how the nonprofit organizations have fared with the IRS. Some complain and some don't.

Now, I am talking now about compliance with the criteria for exemption. This discussion about the Form 990 is a totally different matter. I hear in my practice daily complaints about the Form 990 overall, not just Schedule H but the parts of it as being—and we have heard some of these words this morning—burdensome, redundant, overreaching, and that kind of thing. So there are lots of complaints about the Form 990; but leaving the Form 990 aside, not a lot of complaining about the IRS.

Mr. LEWIS. Thank you. Ms. Aviv, you noted that charitable organizations have struggled financially during the economic downturn. How has the demand for service increased and what do people need?

Ms. AVIV. Congressman Lewis, people need help. The economy hasn't recovered. The demand for service has grown. And the ability of these organizations to get additional funding has been diminished. Individual donor giving is down, and public funding has certainly not increased, particularly State funding. And the ability of these organizations to charge greater fees means that the people who are at the bottom of the economic scale, who have nothing, wouldn't pay more because many organizations charge fees on a sliding scale. Some of these organizations have coped by doing more with less, but there is only a limited amount of time that you can do that.

For the most part what we are being told is that these organizations are finding themselves turning people away. And with your permission, I just want to share with you a story that was shared with us by Catholic Charities. They said that in the fourth quarter of 2011, a snapshot survey of 44 local Catholic Charity organizations located in 29 different States that served about 3½ million clients annually, found that the 44 responding agencies each maintained a waiting list or turned away individuals for services during the fourth quarter, with the greatest areas of unmet needs being in emergency financial assistance and utilities assistance. Even the most basic needs are going unmet in some communities. Three agencies reported turning away at least 1,750 individuals that came to them seeking food.

So what we are seeing is that organizations are not able to keep up with the increased demand.

Mr. LEWIS. What more can Congress do to assist these organizations, not just to do well in the entire private sector, but also to do good?

Ms. AVIV. I mentioned in my remarks, and in my written testimony, that immediately passing the tax extenders, particularly the IRA charitable rollover and the other provisions that affect the charitable community, would be a big help.

When Congress first passed the IRA charitable rollover, some of us had concerns that the only organizations that would benefit were those who were attached to high-income individuals, and that that might be universities, it might be cultural institutions. But in fact what we have found is that many different kinds of organizations, including health and human services organizations, are the beneficiaries of those kind of funds. That provision was not extended at the end of last year and we are concerned that it still hasn't been extended. It is an easy fix and it is certainly one of the ways to help these organizations.

Mr. LEWIS. Thank you very much. Mr. Chairman, I yield back.

Chairman BOUSTANY. I thank the ranking member. I now recognize Mrs. Black.

Mrs. BLACK. Thank you, Mr. Chairman. Let me go to you, Mr. Regier. In your testimony you noted that VHA has worked with the IRS in its design of the new Schedule H; yet you express concerns regarding the clarity on the form. And I know that the chairman talked about the 990. How receptive has the IRS been with working with you and your organization and your other members about your concerns?

Mr. REGIER. I think in our experience the service has been very open to receiving input, and so they have in many ways requested input and solicited input in advance of issuing their formal guidance. And I must say the IRS did agree with the request that we made to make certain provisions of the Schedule H optional for certain filers for a year. Those are questions, however, that are information gathering items in the Schedule H which we believe makes the schedule confusing. We did ask the IRS to extend that and make that voluntary or to eliminate it. We did not get a favorable response there. I would say we have had some success in shaping the form to the better as we see it for our membership, but we would like to see more.

Mrs. BLACK. Well, other than the category you just spoke of to make it voluntary, what other specific concerns do you have on that schedule?

Mr. REGIER. I think the new Schedule H compared to the former one has now expanded significantly in its length and detail, so there is now I think more than 60 subparts to the schedule. We saw the adoption of it as a pretty significant increase in the filing responsibility for the exempt organization.

Mrs. BLACK. Let me go to your testimony where you state that many of the documentation requirements related to the community health needs assessment are burdensome. And as you know, these requirements are designed to ascertain whether each tax-exempt hospital is truly providing the requisite community benefit to qualify for tax exemption. So given this weighty task, do you propose an alternative method of demonstrating to the IRS that every tax-exempt hospital is meeting those requirements?

Mr. REGIER. I think the concern that we have is not about demonstrating that the requirements have been met, it is more about the way that one—the process that is being prescribed for the needs assessment. The guidance that has been issued by the service so far for the community health needs assessment is very detailed in what you have to do to document what you have done. So for example, to list by name, by organization, the persons that you consulted with who you thought were public health experts; to list by name, and their indication of their community or status, the persons that you consulted with that represent low-income or specific disease populations. Leaving aside the question of privacy concerns, that is a level of detail about and prescribed detail about what you must supply and report about your process of assessing community need that we think really misses the point; the point of which is, here are the needs that are present in the communities that we are serving.

The other concern I would say we have about the guidance so far really is the question of how this kind of assessment and planning is done in particular in multi-hospital systems. So multi-hospital systems that may extend through a State or across many regions typically plan on a systemwide basis and there are efficiencies to be obtained from that. The reporting scheme, however, that is set up, which is driven by the statute, is very siloed, so it is requiring reporting to be done on a hospital-by-hospital-by-hospital basis, along with an implementation plan that would be separate for the hospital-by-hospital-by-hospital basis. We would love to see something that would allow a system to have a greater degree of flexibility, to show within the report how the individual hospitals are meeting needs without having to do this kind of siloed hospital-by-hospital kind of approach, which is how we see the guidance shaping up so far.

Mrs. BLACK. And I think you make a very good point there. In certain hospital systems, you may have one hospital in an area that provides a great deal of community needs and maybe in another sector of that same system not so much so. But if there could be some coordination there, so the silo effect.

Is there anything else that you would like to offer in this testimony to say how you think this could be made better on that?

Mr. REGIER. I guess the overall concern I have is that today we are asking health-care organizations to become much more accountable in different ways to help manage and promote the wellness of the community. We want to keep people well, keep them healthy and be rewarded for that, or that is what government seems to be telling health-care providers. The community health needs assessment could be a very powerful tool to inform that work. I am concerned and we are concerned that it won't be if we ask our providers and multisystem providers to look on this siloed hospital-by-hospital basis. We don't achieve population health and wellness in that way, we don't achieve and meet the needs of communities and regions in that way. So that is the only thing I would say.

Mrs. BLACK. Thank you for your testimony. I yield back.

Mr. BOUSTANY. Thank you. Ms. Jenkins, you are recognized.

Ms. JENKINS. Thank you, Mr. Chairman. Thank you for holding this hearing, and thank you all for joining us.

Mr. Colinvaux, in your testimony as well as in your recent article in the Florida Tax Review, you raised the issue of the distinction between public and private charities. You stated that the distinction is one of form rather than substance and that the distinction is beginning to collapse from its own weight. As an example, you mentioned the different standard that applies with respect to self-dealing between a charity and the insiders. Can you just elaborate for us on the distinctions in law between a public charity and a private charity?

Mr. COLINVAUX. Sure. Thank you for the question, Ms. Jenkins. By saying that the distinction is one more of form than substance, what I mean by that is that we take a public charity and a private foundation. Well, what makes a public charity public and what makes a private foundation private? Well, the private foundation is private not because of what it does but because it is funded really by one person or by a family, not because of its underlying charitable activity. And so Congress has looked at that shape, the form of the foundation, and said that shape is more likely to result in abuse because it doesn't have a donor community making contributions to it, it also doesn't have a service community so that there is no base to effectively oversee the foundation. So the form of the foundation is then disfavored relative to the public charity. So that is why it is a distinction of form and not substance.

Why I think it is starting to collapse is because when Congress made that distinction in the law in 1969, it was very much an anti-abuse focus. That is, we said certain forms of charity are more subject to abuse, so they should be subject to the private foundation anti-abuse regime. What we have now seen in recent years has been more abuses at public charities, and one of the congressional responses, then, is to look to the private foundation rules, say here we have a set of rules that regulate abuse, why don't we apply those rules to public charities? And so the self-dealing rules are an example of that.

The private foundation approach to self-dealing is quite harsh. It says if there is a transaction; that is, if there is a loan between the charity and a disqualified person or a sale of property between the charity and the disqualified person, then it is self-dealing.

The approach under the public charity rules is different. You have to decide whether there has been an excess benefit. So it is a very different analysis, and by saying it is collapsing, I am saying that the more we use the public—the private foundation rules to regulate abuses, the less distinct these two types of charities become.

Ms. JENKINS. Okay. So did I just hear you say that you believe that the anti-abuse rules that pertain to private charities should apply to public charities?

Mr. COLINVAUX. Well, not across the board. What I think would make sense is to look at the types of abuses we have identified. So there are a number of abuses: Self-dealing, excess business holdings, the expenditures for nonexempt purposes. We should look at those abuses, decide whether those abuses, first of all, still matter. Some people would argue that we don't—we are not worried about some abuses anymore. We should look at the abuses, decide if they still matter, and if they do, then maybe apply the private foundation rules not based on whether you are a public charity or a private foundation or not but just apply them because we want to regulate the abuse.

Ms. JENKINS. I see. You also mentioned in the Florida Tax Review article that a largely unexamined facet of the charitable sector is the ownership by public charities of for-profit enterprises. Given that is an area that has remained largely unexamined, can you just elaborate on some of the reasons why a tax-exempt organization would own a taxable, for-profit enterprise and how prevalent this practice is?

Mr. COLINVAUX. Well, I can't really comment on how prevalent it is, but I know it is fairly common. There is no rule against it. So, first of all, there is a rule against it for private foundations. Private foundations cannot have excess business holdings. Public charities may, and because they may, they do. So why? Well, I think one of the reasons is because they want to do more than just the charitable work. They want to do other activities that may be related to the charitable work. So they set up a for-profit business and separately incorporate it. There is no rule against it. It is not necessarily bad, but it is something that we haven't thought about a lot as to whether we want to encourage it or not encourage it.

Ms. JENKINS. Okay, thank you so much. I yield back.

Mr. BOUSTANY. Mr. Reed, you are recognized.

Mr. REED. Thank you, Mr. Chairman. Ms. DeStefano, if I could ask you a question in regards to your testimony, and I do appreciate you being with us today, you had mentioned in your testimony and when I read your testimony the compliance that you had with the Form 990, and you had mentioned something in your verbal testimony today about the K–1 and the side issues. I wonder if you could elaborate for me a little bit more in detail exactly what you are referring to in regards to that additional requirement.

Ms. DESTEFANO. Currently the 990 is an informational return, and it reconciles with our financial data and our balance sheet of our audited financial statements. K–1 data typically will be used for institutions like Cornell that have large endowments where we are invested in partnerships, and we receive K–1s. The K–1 data is not part of our official university records. If we are required to now take a return full of data that reconciles with our financial statements and have financial statement data and other data commingled, the reconciliation issues and the amount of time to validate the accuracy of the reporting expands exponentially. So we are recommending that for the informational return that we stay with financial statement data that is already audited and can tie to something that someone else has already reviewed.

Mr. REED. Well, that makes sense to me, and that is a really a good common sense suggestion. Is there any way, in your mind, that you could quantify the type of burden that you would have to comply with if we went down——

Ms. DESTEFANO. I don't have the answer, but I can speak with my staff——

Mr. REED. I would appreciate that.

Ms. DESTEFANO [continuing]. And provide a response back.

Mr. REED. And obviously any resources that you allocate to this compliance issue is taking away from your educational mission, correct?

Ms. DESTEFANO. Exactly, it is additive.

Mr. REED. And from your experience with the compliance audit, could you offer any insights to us as to what worked, what didn't work from your perspective in dealing with the IRS?

Ms. DESTEFANO. So we spent 2 years going through the compliance audit. We had approximately 15 staff members involved. The IRS looked at every single transaction for fiscal year 2008. We spent a significant amount of time educating the IRS on the higher ed industry. I think that the auditors after 2 years now understand our industry. The one thing, though, that we felt might be helpful is apparently the 990 and the 990–T did not provide sufficient data to determine what should be audited, and as a result, the IRS created a questionnaire and at Cornell we felt that the way the questionnaire was, the questions were phrased, and that is what determined what is to be audited, the IRS should seriously take a look at what those questions were phrased, was sufficient to determine areas of audit if the return itself didn't identify the areas that they should come in and take a look at the survey questions, perhaps they were more effective.

Mr. REED. Very good. I appreciate that testimony, and I look forward to receiving your additional material and that estimate of impact on your K–1 compliance requirement.

With that, Chairman, I would yield back.

Ms. DESTEFANO. Thank you.

Mr. BOUSTANY. Thank you, Mr. Reed.

Mr. Kind, you are recognized.

Mr. KIND. Thank you, Mr. Chairman. I want to thank our panelists for your testimony here today. I appreciate this opportunity to have this hearing on tax-exempt organizations. Mr. Colinvaux, I think you are right, I think we are going to have to maintain lines of communication and learn more before we are ready to dive into comprehensive tax reform and help us to do that. But listening to almost all of you here today, I am being left with the impression, especially with the 990 form, that the IRS has not been all that responsive in receiving feedback or suggestions on how we might be able to streamline or simplify the 990 form.

Is that the impression that you have or have they been responsive to feedback that various organizations have been giving them on how they can help simplify the 990 form? Mr. Regier, do you want to take that first?

Mr. REGIER. Sure. And I don't want to leave the impression that the IRS has been unresponsive. They have not been. Through our dialogue, we have clarified some pretty important issues related to the Form 990 and the Schedule H, so, for example, they have been helpful in clarifying just what kind of hospital facility is required to comply with the new requirements in helping to define what it means to widely publicize your financial assistance policy. So I can point to, you know, four or five areas in particular that we think have been very helpful clarifications that have come out of that dialogue.

That said, there is still at least that many or more where we believe there is some further help that is needed, and the biggest degree of help would be if we were able to get actual proposed or final regulations related to these new requirements, most of which have been in effect since the Affordable Care Act was signed in 2010.

Mr. KIND. Anyone else have an opinion on how responsive the IRS has been? Ms. Aviv?

Ms. AVIV. Mr. Kind, our experience is actually quite different from what the question might suggest. When the Pension Protection Act was passed, we worked closely with the IRS on the reform of the 990 the first time, and we found that they invited us in and many other organizations in to talk to them about what the concerns were, what the changes needed to be. When we offered our comments during the public comment period, they followed up with us. When they put in place the Pension Protection Act requirement that organizations that failed to file would lose their tax exempt status they went out of their way to provide notices across the board and on their web site to make sure that everybody knew when a number of organizations got caught in that that still existed. The idea was to clear out the inventory of those organizations that no longer existed so we have an accurate count of how many organizations there actually are. They worked assiduously to try and get those organizations reinstated. We found them responsive to our concerns, including questions, in a serious way. I think that is different than the question of the burdensomeness of the 990 form which many organizations feel is beyond their capacity and the expense capability and takes away from programs.

Mr. KIND. I am sympathetic, too. And obviously we get testimony from the IRS themselves. It seems as if as a body we are asking them to do more with less, and these things are becoming more complex every year, and yet we are asking them to render good, effective service and responsive service to all of you, too.

Mr. Hopkins, let me turn to you real quickly on a different line. Obviously, we have seen a real growth in (c)(4) activity off of the social welfare organizations, and we are also noticing stepped-up political involvement with a lot of the (c)(4)s out there. Is that an area that the Congress should be paying a little bit more attention to or even the IRS paying attention to, in your mind?

Mr. HOPKINS. Well, absolutely. Certainly the IRS is paying attention to it now. The IRS, as you probably know, has gotten a substantial number of applications from organizations that want to be 501(c)(4)s, and some of them have a substantial amount of political campaign activity planned, and the position of the IRS is that if that is the entity's primary purpose, it can't qualify under 501(c)(4). There has been, for example, a recent ruling, the first ruling of the current batch was adverse to an entity that wanted to be a 501(c)(4). The IRS decided that 80 percent of what it wanted to do consisted of political activity. So the IRS is right now processing a lot of applications in that area.

Mr. KIND. Well, what is your opinion on requiring disclosure of contributions to (c)(4)s?

Mr. HOPKINS. Well, that of course is not the law at the present time.

Mr. KIND. Right.

Mr. HOPKINS. And we do have the alternative, the 527 political entity, and that kind of an organization does have to make its donors public, and public charities have to disclose their donors but only to the IRS, and private foundations have——

Mr. KIND. It just seems that a lot of the (c)(4)s are being used in order to allow these anonymous contributions to be made for, in essence, political activities.

Mr. HOPKINS. That is one of the principal reasons, frankly, that (c)(4)s are being utilized in this regard is so that the donors do not have to be disclosed. So if the question is—and this is purely a matter of policy. Should donors or at least large donors have to be identified to 501(c)(4) entities? I mean, that is obviously well within the prerogative of Congress' decision making, and certainly that rule could be enacted.

The question to me is, you know, what would be the consequence of that? Would it be to discourage contributions, political contributions to (c)(4)s? Probably to some degree. And maybe that is what is desired. But certainly as a matter of transparency I personally don't have any problem with having that sort of a rule, although probably as a matter of fairness if that kind of rule were to be enacted, maybe some other categories of exempt organizations ought to have the same rule, (c)(5), (c)(6)s, for example, but as a matter of transparency on balance it is probably a good idea.

Mr. KIND. Right, right. Thank you. Thank you, Mr. Chairman.

Mr. BOUSTANY. Thank you, Mr. Kind. We will go next to Mr. Paulsen.

Mr. PAULSEN. Thank you, Mr. Chairman, also for holding the hearing today.

Mr. Colinvaux, let me just shift back to something I think you referenced in your testimony before about the enforcement problems that are faced by the IRS than being due to a lack of positive requirements for tax-exempt status. Can you elaborate a little bit on that point, and do you agree or do you believe that this is not an enforcement problem that can be resolved simply by increasing the IRS budget to audit charities? Is there more to it?

Mr. COLINVAUX. I do think there is more to it. I think a lot of what we are hearing about the 990 and the information burden, what is driving a lot of the information question to me really goes to what we mean when we say compliance, what do we mean by compliance. And partly what policymakers and others are concerned about is whether or not an organization is providing a public good. Well, there is no legal requirement, really, that the organization provide a public good. They just have to be organized for a good purpose. So we want all this information in order to assess a substantive question, which is, is the organization doing good. But there aren't really legal requirements to back that up. Rather, the legal requirements are more you may not pay excess compensation, you may not engage in campaign activity, you may not engage in substantial lobbying.

So a lot of the enforcement efforts are tailored to that sort of compliance, and one quick note which I think is very significant, the governance initiative, we have talked a lot about governance. One of the reasons I think the IRS is looking at governance is because if the IRS can decide that good governance means better compliance, that means you will have a better run organization, fewer abuses, and maybe also more public good is being produced. So it is something the IRS can do. It is something they can look at. I think part of what they are doing with the 990 is gathering information to see what information works and what helps them oversee the burden.

Mr. PAULSEN. You also noted that the new hospital requirements are a recent example of Congress imposing a positive requirement on organizations in order to support their tax-exempt status. Do you think that this type of sort of anti-abuse positive requirement structure would also be useful in other areas of the tax-exempt sector?

Mr. COLINVAUX. I think potentially yes, although with hospitals in a way the new rules fall short of a strict positive requirement, and that is where some context is useful there, too, because leading up to the new Section 501(r), the question was whether an affirmative duty of charity care should be imposed on hospitals, and Congress didn't go that route. Instead they went the route of requiring more process-based requirements; namely, more paperwork, more proof of the community benefit without actually defining what the community benefit is. So I think partly you are seeing more process being layered on community and charitable organizations as a substitute for requiring some affirmative duty.

Mr. PAULSEN. Thank you, Mr. Chairman. I yield back.

Mr. BOUSTANY. I thank the gentleman. Mr. Becerra, you are recognized.

Mr. BECERRA. Mr. Chairman, thank you very much, and let me congratulate you on this hearing. This is something that we should be doing quite a bit more, I hope, and it is great to have the testimony of all the witnesses.

Ms. Aviv, a pleasure to see you again, always a pleasure.

Let me make sure about something, and Mr. Colinvaux, maybe this is a question I should direct at you. Close to two million tax-exempt organizations, at least that was a 2008 number, and my understanding is that in 2008 there were some 7,900 audits by the IRS performed of these tax-exempt organizations. So if my quick math is correct, less than 1 percent of organizations that qualify for tax-exempt status are audited by the IRS. Is that about right?

Mr. COLINVAUX. It sounds about right.

Mr. BECERRA. I actually know something more than you do on this; okay, that is good. That is a good way to start. At least those are the numbers I have, which to me is perhaps one of the reasons why we do have these issues, that there isn't enough oversight, and with these fuzzy rules on who qualifies and who doesn't, it is not surprising that we have so many entities applying to become tax-exempt organizations. Many of them do great work. We are finding, unfortunately, that some don't. And the sector, because it probably doesn't do as much as it can to police itself and because the IRS hasn't focused on doing more enforcement and oversight can't do it either or hasn't done it either, it seems that there are a lot of entities operating here that perhaps would not qualify, and the result is that a lot of American taxpayers are watching their taxpayer dollars go for noncharitable, nonpublic good purposes.

Let me ask, Mr. Colinvaux, a question to you because you focused on this issue of enforcement, and having more effective enforcement would include having brighter lines, more positive requirements you have mentioned. Give me a sense, give me something tangible in terms of brighter lines. For example, what would you qualify, having, for example, a tax-exempt organization have to provide some information on its outcomes and activities that it is engaged in to have that status?

Mr. COLINVAUX. Well, it is very hard for me to judge, but in part yes. I think what I am trying to argue is that our current system is one that is based on purposes which, as you suggest, means a lot of organizations can qualify, and once they qualify they tend to remain exempt. So in terms of looking at more positive requirements or brighter lines, one of the things I think we ought to be thinking about is whether we should shift away from just purposes and also towards activities, which is to look at the activities of an organization, maybe require a certain threshold of an activity, maybe do more work in terms of defining what a charitable purpose is. I also think it is important to remember that we don't have to view all of the tax benefits together. Right now we do. We put everything under 501(c)(3), and deductibility and tax-exempt financing flow from that. We don't have to do that. We could look at 170, the charitable deduction, and say are there certain eligibility requirements we want to impose on donations, on certain types of organizations that can receive donations? Do we want to prioritize certain types of charitable purposes over others? Those are the sorts of questions I think we should be asking.

Mr. BECERRA. And that would help people understand where those tens of billions of dollars that—well, actually even more money that is being contributed by Americans to these nonprofits, how it is being used and how it is that they are—those entities are now getting to shield those resources from taxation. So you make a charitable contribution, you get to write off that on your taxes, the organization has tax-exempt status, doesn't have to pay taxes the way a for-profit entity would have to pay. Therefore, it is in a better leveraged position than that for-profit entity. So taxpayers should be entitled to some sense of what is being done with the money since at the end of the day it is taxpayers who are covering the cost of giving these entities this tax-preferred status.

Mr. COLINVAUX. Yes, I generally agree with that, and that is why I think looking at 170, the charitable deduction in particular, that is where the Federal interest is quite strong.

Mr. BECERRA. I do have a concern with these 501(c)(4) organizations, these welfare organizations. We are finding more and more how they are going into the political side of things and, Mr. Hopkins, you testified to that. But I know my time is about to expire.

Mr. Chairman, I know you are planning to have more hearings on this issue. I hope we do. I hope we have the IRS here. I believe that the more we do to examine this sector, the better off those that are doing phenomenal work will be able to have contributions made by Americans because they will know, in fact, that their money is going to great purposes, and so I hope we get on this. Thank you, Mr. Chairman.

Mr. BOUSTANY. Thank you, Mr. Becerra.

Mr. Marchant, you are recognized.

Mr. MARCHANT. Thank you, Mr. Chairman. This question is for Ms. Aviv. As part of its Good Government Initiative, the independent sector has identified 33 principles in its Principles for Good Government and Ethical Practice Guide to help tax-exempt organizations with operations and transparency. Are any of the 33 principles reflected in the revised Form 990?

Ms. AVIV. Mr. Marchant, I would have to get back to you on that, and I will check and do in writing to make sure that they are there. Let me say that the general point of these principles was for them to be applied to ourselves by ourselves. This was a set of voluntary principles that we put forward. We said that in order for this not to be a government compliance area, we need to step up to the plate and support standards of good governance and ethical practice that we impose upon ourselves. So the purpose was not to encourage further government action in this regard, believing that there were whole areas of governance that organizations themselves have a responsibility to fulfill. That is why we are so pleased that so many organizations have stepped up, downloaded this document, and are using it in order to improve their practice. We believe the more we step up, the less need there is for government to step in.

Mr. MARCHANT. Are there some principles not incorporated in the form that you think should be?

Ms. AVIV. I will have to get back to you on that in writing. I would be happy to do that.

Mr. MARCHANT. Well, thank you. Thank you very much.

Welcome to Mr.—how do you say it?

Mr. REGIER. It is Regier.

Mr. MARCHANT. Regier. Welcome. Your offices are in my district on Las Colinas.

Mr. REGIER. Yes, absolutely.

Mr. MARCHANT. It is good to see you here today.

I have a couple of questions for Mr. Hopkins. Can you briefly describe the distinction between a 501(c)(4) and a 527?

Mr. HOPKINS. I can do it. Whether I can do it briefly or not is another matter.

Mr. MARCHANT. Well, in the amount of time that I have left.

Mr. HOPKINS. Let me put it this way, they are both discrete categories of tax-exempt organizations. The 527 entity has as its primary purpose political campaign activity. The flip side is a 501(c)(4) cannot have that as its primary purpose and must have as the promotion of social welfare its primary purpose. So the primary purpose test takes those two organizations in different directions.

We have talked about the donor disclosure rules. They apply to 527s. They do not currently apply to 501(c)(4)s. The 527 organizations are taxable on all of their revenue from nonexempt functions whereas a 501(c)(4) would be taxable only on its unrelated business income. And the only other item that I can—or element that I can think of that would differentiate between the two is that the reporting for political organizations is far more complex and frequent than is the case for the 501(c)(4) organization.

Mr. MARCHANT. Well, there has been a lot of recent activity out in the country among some of our activist groups that are complaining that the IRS is putting an incredible paperwork burden on them to prove that they should have the status that they have, and I am assuming that these are 501(c)(4)s that are—the accusation is that they are doing 527-type activity; is that correct?

Mr. HOPKINS. That is absolutely correct.

Mr. MARCHANT. And the IRS, I am getting a lot of complaints from my constituents that feel like that they are perfectly justified and are following all the rules under 501(c)(4) but that the IRS has singled them out for audit, for hundreds and hundreds of pages of forms, and has this always been the case or is this a recent phenomena?

Mr. HOPKINS. This is a recent phenomenon in my judgment for two reasons. One, 501(c)(4)s, of course, do not have to file to begin with, and so the practice in many, many instances up till recent times has been for an organization to form as a 501(c)(4) and just go forward and not even go through the application process. Why there has been this upsurge in application activity is not entirely clear to me, but the impression I have gotten based on the limited amount of experience derived from my own practice is that for some reason the IRS does seem to be asking for a lot more detail in this context than they might otherwise.

Mr. MARCHANT. I would hope, Mr. Chairman, that at some date we will have the IRS here so that we can specifically ask the IRS, you know, why is there this sudden new focus on these groups. Thank you. Thank you, Mr. Hopkins.

Mr. BOUSTANY. Thank the gentleman, and I share his concern.

This concludes all the questioning. I want to thank each of you for coming here today and being witnesses and for your testimony. I want to remind you all that members may have some additional written questions that they might submit to you, and your answers to those as well as the questions would be made part of the official record.

This has been a very helpful hearing. The information you provided to us has given us some good guidance as we look at this whole area of tax-exempt organizations. This hearing is now adjourned.

[Whereupon, at 11:30 a.m., the subcommittee was adjourned.]

[Submissions for the Record follow:]

American Association of Museums

AMERICAN ASSOCIATION OF MUSEUMS

Statement by
Ford W. Bell, DVM,
President of the American Association of Museums,
www.aam-us.org
to the House Ways and Means Committee
Subcommittee on Oversight
Hearing on Tax Exempt Organizations
May 16, 2012

Chairman Boustany, Ranking Member Lewis, and members of the Subcommittee, thank you for allowing me to submit this testimony. My name is Ford Bell and I serve as President of the American Association of Museums (AAM).

AAM is proud to work on behalf of the 17,500 museums that employ 400,000 people, spend more than $2 billion annually on K-12 educational programming, receive more than 90 million visits each year from primary and secondary school students, and contribute more than $20 billion to local economies. AAM is proud to represent the full range of our nation's museums – including aquariums, art museums, botanic gardens, children's museums, culturally specific museums, historic sites, history museums, maritime museums, military museums, natural history museums, planetariums, presidential libraries, science and technology centers, and zoos, among others, most of which are tax-exempt non-profit organizations.

I urge Congress to recognize that museums are public institutions that serve all communities. They depend on charitable gifts for more than one-third of their operating funds and, especially as a result of the economic downturn, have seen a decline in charitable gifts. Many museums have been forced to cut back on staff, programs, or hours. Some have even closed down entirely. Many of those that remain open face a very uncertain future, even as the demand for their programs and services increases.

The House recently approved a budget that calls for significant reductions – or elimination – of funds that support museums. To make matters worse, the report language specified that museums and similar organizations could "make up the difference" through increased charitable giving.

At a time when federal, city, and state governments are making tough choices about budget priorities – leaving many important programs underfunded -- Congress can play a vital role in spurring private giving by expanding charitable giving incentives. Here are three areas where Congress could help charitable institutions attract contributions.

- Deductibility of Charitable Gifts -- We urge Congress to oppose proposals to limit the deductibility of gifts, which would hurt charitable organizations, including museums, by

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creating a disincentive for the most generous taxpayers. This is especially harmful at a time when charitable organizations are facing enormous financial challenges stemming from the economic downturn. The Giving USA Foundation recently reported that in 2008, the decline in total charitable giving was the greatest since the organization began tracking charitable donations in 1956. 2009 was just as devastating for some charities, which after years of public service, closed their doors for good. Studies indicate that donors give for many reasons —incentives such as tax deductions being among them. While Americans do not make charitable gifts only for tax reasons, tax incentives make more and bigger gifts possible. This has been recently demonstrated: During times of crisis, such as the natural disasters like Hurricane Katrina, the 2008 Midwest flooding, and earthquakes in Haiti and Chile, Congress has passed charitable giving incentives to make it easier for Americans to give donations and support to the nonprofits serving individuals, families and communities in need. The president has proposed to reduce the value of itemized deductions for charitable contributions in his FY13 budget. Under current law, a gift generates a tax deduction that is equal to the tax rate. For example, a taxpayer in the 35% bracket who gives $1,000 gets a tax saving of $350. Under the president's proposal, the same gift would generate a tax saving of $280. In effect, this means that a portion of donated income is taxed. It is estimated that charitable gifts would fall by about $7 billion annually if the proposal is approved.

- IRA Charitable Rollover -- We urge Congress support a permanent extension of the IRA Charitable Rollover. This tax incentive allows individuals aged 70½ and older to donate up to $100,000 from their Individual Retirement Accounts (IRAs) and Roth IRAs to public charities without having to count the distributions as taxable income. Since enactment in August 2006, the IRA Charitable Rollover has generated a significant amount of new charitable giving. Congress has temporarily extended these giving incentives in the waning days of the calendar year for the past few years, making it less effective as a mechanism for the public to make charitable contributions, and unfortunately let it lapse at the end of 2011. We support the effort by Reps. Wally Herger (R-CA) and Earl Blumenauer (D-OR), as specified in H.R. 2502, the Public Good IRA Rollover Act of 2011, to make the IRA Rollover permanent, remove the arbitrary $100,000 cap, and reduce the qualifying age to 59 ½.

- Artist-Museum Partnership Act -- We urge Congress to allow artists to deduct the fair market value of donated works. Living artists, writers, scholars, choreographers, and composers – many of whom earn very little – have no financial incentive to donate their works, because they cannot claim a tax deduction for the works' fair market value. Rather, they can deduct only the value of materials, such as paper, ink, paint, and canvas. As a result, works of local, regional, and national significance are sold into private hands and are never made available to the public. Small and mid-sized museums – which often do not have the same financial resources and support as larger institutions – rely especially upon donations from creators to build and enhance their collections. We support the Artist-Museum Partnership Act of 2011, H.R. 1190, introduced in the House by U.S. Representatives John Lewis (D-GA) and Todd Platts (R-PA). The bill provides that a deduction equal to fair market value shall be allowed for charitable contributions of literary, musical, artistic, or scholarly compositions created by the donor, provided that the recipient organization use the work in a manner related to its charitable mission.

I want to reiterate that museums are public institutions that serve every community in every corner of our nation. Here are a few examples of how museums are benefitting their communities:

- Museums are key education providers. Each year, museums spend more than $2.2 billion on educational programming and provide more than 18 million instructional hours to students and teachers, including the following: educational programming for students, museum staff visits to schools, traveling exhibits in schools, professional development for teachers, more than 90 million visits each year from school students. The typical museum devotes three-quarters of its education budget specifically to K-12 students. In 2010, despite a year of economic stress, 78% of museums maintained or expanded the resources devoted to K-12 education. Museums already offer educational programs in math, science, art, literacy, language arts, history, civics and government, economics and financial literacy, geography, and social studies, in coordination with state and local curriculum standards. Museums also provide experiential learning opportunities, STEM education, youth training, and job preparedness. They reach beyond the scope of instructional programming for schoolchildren by also providing critical teacher training. There is a growing consensus that whatever the new educational era looks like, it will focus on the development of a core set of skills: critical thinking, the ability to synthesize information, the ability to innovate, creativity, and collaboration. Museums are uniquely situated to help learners develop these core skills.

- Museums address community challenges. Many museums offer programs tailored to seniors, veterans, children with special needs, persons with disabilities, and more, greatly expanding their reach and impact. For example, some have programs designed specifically for children on the autism spectrum, some are teaching English as a Second Language, and some are serving as locations for supervised family visits through the family court system. In 2011, more than 1,500 museums participated in the Blue Star Museums initiative, offering free admission to all active duty and reserve personnel and their families from Memorial Day through Labor Day. Even more museums are expected to participate in the program this year.

- Museums create jobs and support local economies. Museums serve as economic engines, bolster local infrastructure, and spur tourism. Both the U.S. Conference of Mayors and the National Governors Association have recognized that cultural assets such as museums are essential to attracting businesses, a skilled workforce, and local and international tourism. Museums pump more than $20 billion into the American economy, creating many jobs.

- Digitization and traveling exhibitions bring museum collections to underserved populations. Teachers, students, and researchers benefit when cultural institutions are able to increase access to trustworthy information through online collections and traveling exhibits.

I thank the Subcommittee for holding this important hearing and for accepting public witness testimony. I urge the Subcommittee to do all it can to incentivize private charitable giving to help nonprofits continue to serve their communities, especially at a time of reduced public funding at all levels of government.

Thank you once again for the opportunity to submit this testimony.

American Bankers Association

May 16, 2012

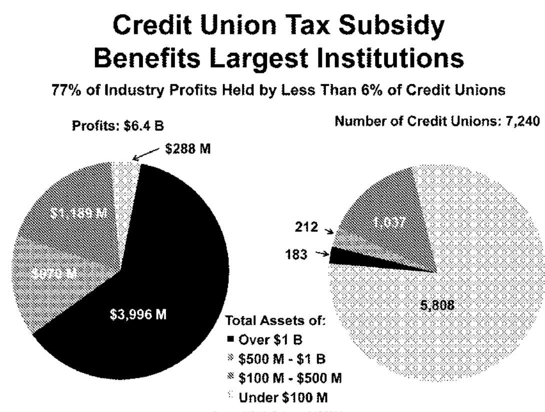
Statement for the Record
For the May 16 Hearing on
Tax Exempt Organizations
on behalf of the
American Bankers Association
before the
Oversight Subcommittee
of the
Committee on Ways and Means
United States House of Representatives

Chairman Boustany, Ranking Member Lewis and members of the Subcommittee, the American Bankers Association (ABA) appreciates the opportunity to submit a statement for the record for the hearing on tax-exempt organizations. The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its two million employees.

While the hearing focused on compliance and reporting requirements for universities and hospitals, our comments focus on the compliance and reporting issues for another, tax-favored sector: credit unions. Originally credit unions were created and granted their tax exemption to serve people of modest means. However, many of these tax-exempt organizations have now morphed from serving "people of small means" to become full service, financially sophisticated institutions that compete head-to-head with local taxpaying banks.

ABA commends the Subcommittee for its plans to hold a series of hearings on tax-exempt organizations. We encourage the Committee to hold a hearing specifically on credit unions as tax-exempt entities. Credit unions represent a significant tax expenditure: since 2001 they have enjoyed the privilege of ***not paying an estimated $20.5 billion in federal corporate income taxes.*** They have almost twice the assets as tax-exempt institutions in higher education and fifteen percent more assets than tax-exempt hospitals. The size and taxpayer benefits conferred certainly make them worthy of careful Congressional investigation to assure this large tax expenditure is directed where Congress intended.

Many of today's credit unions are a far cry from the small, traditional credit unions that served distinct groups of "people of small means," which Congress sought to assist when it provided tax subsidies to credit unions in the 1930s. There are now 183 credit unions that have more than $1 billion in assets each; these credit unions hold 48.6 percent of all credit union assets but represent only 2.5 percent of the total number of credit unions. ***These 183 large credit unions are larger than 91 percent of all banks, and nearly indistinguishable from taxpaying community banks.*** Indeed, these credit unions compete for the same loans as their community bank counterparts, but credit unions pay no taxes. Credit unions were not intended to be simply tax exempt banks.



As Congress examines the affordability of tax expenditures in the face of rising debt levels, it should target the credit union tax expenditure. The need for the credit union tax exemption has all but disappeared.

In this statement, ABA's comments will focus on three key points:

- Transparency requires credit unions to successfully demonstrate service to people of modest means to assure taxpayers their tax subsidy is being properly employed.

- Federal credit union corporate governance disclosures should mirror those of most tax exempt institutions.

- The credit union tax exemption should be eliminated, particularly for credit unions that have strayed from their mission of service to people of modest means.

I. Credit Unions Should Be Required to Demonstrate Service to People of Modest Means

Tax exempt institutions should be required to demonstrate to taxpayers that the tax subsidy is being used as Congress intended. Credit unions have no requirement now to do so.

The exemption in the tax code for credit unions was created in the early 20th Century to incent more consumer lending, especially to people of modest means, because at that time there were fewer options to obtain credit. This was reaffirmed when Congress passed the Credit Union Membership Access Act of 1998:

> [C]redit unions, unlike many other participants in the financial services market, are exempt from Federal and most State taxes because they are member-owned, democratically operated, not-for-profit organizations generally managed by volunteer boards of directors ***and because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means.*** [emphasis added]

Credit unions steadfastly refuse to define "modest means," thus evading the simple determination of whether they are fulfilling their mission. Available evidence shows that they are not. According to data from a 2006 study by the U.S. Government Accountability Office (GAO), credit unions serve proportionately more upper income customers than banks and fewer low-income customers than banks. The GAO found that "14 percent of credit union customers were of low-income and 17 percent were of moderate-income, compared with 24 percent and 16 percent for banks."[1] Moreover, GAO found that 49 percent of credit union customers were upper income compared to 41 percent for banks.

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[1]United States Government Accountability Office, Credit Unions: Greater Transparency Needed on Who Credit Unions Serve and on Senior Executive Compensation Arrangements, November 2006, GAO-07-29, p20.

Moreover, credit unions' own surveys suggest that their image of serving moderate and lower income people is no longer valid. The typical credit union member has higher than average income, more years of education and is more likely to own a home than non-credit union members.[2] Thus, the credit union tax expenditure is subsidizing financial services to individuals who do not need it and who otherwise have access to basic banking services. Basic transparency would surely shine light on this discrepancy.

More concrete demonstration of serving people of modest means is needed. This was what the GAO recommended in two studies, one in 2003 and the other in 2006, suggesting that NCUA develop more tangible indicators to determine whether credit unions have provided greater access to services in underserved areas or fulfilled their tax-exempt mission. ***The recommendations have not yet been fully implemented.***

At a hearing in 2005, former NCUA Chairman D'Amours expressed his frustration over past efforts to have credit unions add to their business plans how they intend to reach out to low-income people. He said he had been told by the credit unions during his tenure that "credit unions were never really intended to serve anything but the middle class." He also said that his agency's effort of more than three years was "fiercely resisted." He said at that time:

> It is amazing that we can't get a definition of what "modest means" amounts to. But the truth is that that is not happen stance; they want it that way... I hope that this [hearing]...will result in something positive coming from the U.S. Congress. As I said earlier, if it doesn't come from Congress, it is not going to happen.

With the privilege of federal income tax exemption and a mandated mission of serving persons of modest means or those with moderate and lower incomes, credit unions must be more transparent with those definitions and their application. The current amorphous definition leaves credit union members, taxpayers and tax policy decision-makers without clear and fundamental information to understand how credit unions meet their congressionally-defined mission.

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[2] CUNA National Member Survey, 2002.

II. Credit Union Corporate Governance Disclosures Should Mirror That of Other Tax Exempt Organizations

Credit unions must be more transparent in the information about expenditures, such as executive compensation and charitable donations. Most tax-exempt organizations, including universities and hospitals, must disclose the compensation of senior officials to the Internal Revenue Service in the Form 990—a form that has become an important tool for determining the transparency and accountability of tax-exempt organizations.[3] By publicly disclosing this information, the Form 990 fosters good corporate governance as it attempts to ensure that the tax expenditure is being appropriately employed.[4]

State-chartered credit unions are required to file a Form 990, but federal credit unions are not. Since federal credit unions are cooperatives, the member-owners have a right to know the total compensation paid to senior officials. For example, if Public Service Credit Union of Denver had been a federal credit union (rather than state-chartered), information regarding the $9.8 million base compensation of its CEO and President would not have been disclosed. His 2010 pay package was almost 20 times the average for comparable sized credit unions according to press reports.[5]

Federal credit unions should be required to file Form 990 information just like state-chartered credit unions and most other tax-exempt institutions. Expanding the public's opportunities to review executive salaries would promote improved corporate governance and greater credit union accountability. ***It would inform Congress, taxpayers, and credit union members about whether this valuable tax subsidy is going towards the credit union mission*** or is subsidizing credit union management.

NCUA, as the primary supervisor over these federal tax exempt organizations, has the authority to require all federal credit unions to file this Form 990 information. The GAO suggested this in 2006: "NCUA could require all federally insured credit unions to include

[3]According to data compiled from the Urban Institute's National Center For Charitable Statistics, around eighty percent of registered higher education organizations and hospitals file the form.

[4]Form 990 filers are also required to describe the organization's program service accomplishments for each of its three largest program services.

[5] According to a Denver Post article, the credit union salary data is from Executive Compensation Solutions.

compensation and benefit data for senior executive officers in the call reports that are submitted on a quarterly basis—an option that NCUA officials indicated was under current consideration." NCUA has failed to act.

In fact, NCUA is moving even further away from ensuring transparency by eliminating its charitable contribution rule. Now, any federal credit union can make donations without the prior approval of its board of directors and without regulatory restrictions as to recipients. This makes credit union management less accountable to its members. Congress should insist that NCUA take action for greater transparency and accountability.

III. The Credit Union Tax Exemption Should Be Eliminated

Over the last 75 years, credit unions have changed and for many credit unions their tax exemption is no longer appropriate. Credit unions' expansion into new business activities and the liberalization of their fields of membership—which has allowed credit unions to serve ever-larger geographic areas—has made them indistinguishable from banks. In fact, credit unions are seeking additional authority to make commercial loans, further moving them away from their mission of serving consumers of modest means.

The evidence suggests that the credit union tax exemption is fueling the rapid growth of this industry. Some credit unions are using their tax-exempt status to sponsor college bowl games, build multi-million dollar headquarters or to buy the naming rights to stadiums and arenas. While many credit unions remain true to their original mission, a growing number of credit unions have abandoned their roots and inappropriately taken advantage of their tax-exempt status to gain ever-increasing market share.

Moreover, basic economics tells us that this tax expenditure puts credit unions at a competitive advantage relative to other financial institutions providing identical services, because it distorts economic behavior and the allocation of resources within the financial services sector. The Congressional Research Service said that credit union growth in assets in the 1980s, 1990s and through 2009 was more rapid than other depository industries.[6] In 2005, there were about 260 credit unions with assets over $500 million and a little over 100 with assets

[6]United States Congressional Research Service, Should Credit Unions Be Taxed?, May 2010,97-548, p.17.

greater than $1 billion. Today, almost 400 credit unions have assets over $500 million and those with more than $1 billion in assets have increased to 183. Total credit union assets now exceed $1 trillion.

History has demonstrated that becoming a taxpaying entity does not drive an industry out of business. Savings associations once enjoyed a tax benefit; however, as the industry grew and gained sophistication and powers, the justification supporting the tax benefit evaporated. Congress repealed the tax benefit in 1951 and phased it out over time. Loss of the tax exemption did not drive savings associations out of business; they adjusted and continue to serve their communities and customers.

The Congressional Research Service said, "...many believe that an economically neutral tax system requires that financial institutions engaged in similar activities should have the same tax treatment..."[7] ABA agrees.

IV. Conclusion

Today, credit unions compete head-to-head with local taxpaying banks. Yet the tax treatment of credit unions does not reflect the metamorphosis of credit unions to modern financial institutions. In 2011, banks paid $50 billion in federal income taxes, supporting everything from social services to the defense of our country. Credit unions paid nothing in federal taxes. As the Subcommittee continues to focus on tax-exempt organizations, ABA strongly encourages review of the tax status of the credit unions, particularly with respect to those that have diversified to the point that they bear no resemblance to the traditional credit unions Congress envisioned to be worthy of preferred tax status. The credit union tax expenditure no longer supports the public policy of providing financial services to low- and moderate-income consumers. Abolishing the credit union tax expenditure would help reduce the U.S. debt and eliminate distortions in the financial services industry. Having a hearing specifically on the credit union tax-expenditure would be a good first step in this process.

[7] Ibid., p. 17

American Hospital Association

American Hospital Association

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Statement of the American Hospital Association
before the
Subcommittee on Oversight
of the
Committee on Ways & Means
of the
U.S. House of Representatives

Hearing on Tax Exempt Organizations
May 16, 2012

On behalf of our more than 5,000 member hospitals, health systems and other health care organizations, and our 42,000 individual members, the American Hospital Association (AHA) appreciates the opportunity to submit this statement for the record as the Subcommittee on Oversight of the Committee on Ways & Means examines the operations and oversight of tax-exempt organizations.

Tax-exempt hospitals support the Internal Revenue Service's (IRS) goals for a reporting system to enhance transparency, demonstrate compliance and accountability, and minimize burden. Since the inception of the Form 990 Schedule H for hospitals in 2007, the hospital field has offered assistance and recommendations to the IRS to develop a form that would provide meaningful information. After Congress enacted new requirements for tax-exempt hospitals in 2010 (Section 501(r) of the Internal Revenue Code), the AHA and its members continued every effort to work with the IRS to achieve a reporting system that would provide meaningful information to Congress, the IRS, our communities, and the broader public.

THE REVISED IRS SCHEDULE H TO IMPLEMENT THE NEW 501(r) REQUIREMENTS

A hospital must satisfy each of the new requirements in order to maintain its tax-exempt status under Section 501(c)(3) of the Internal Revenue Code. Unfortunately, the revised Schedule H does not meet the goals that the IRS set and tax-exempt hospitals support. Attached please find our most recent letter to the IRS and the Treasury Department, which addresses the concerns of hospitals regarding both the process in issuing the form and the substance of the changes. It reiterates the significant concerns we have raised with the IRS since 501(r) was enacted.

Beginning with our July 22, 2010 comment letter, which responded to the IRS's request for comment on the need for guidance regarding the newly enacted 501(r) requirements, we have offered specific recommendations for how to achieve Congress' goals while minimizing unnecessary burden for hospitals and providing meaningful information to the public. We pointed out that the original Schedule H included questions that addressed most of the new requirements. We advised that the Schedule did not need a complete overhaul and that revising the instructions for certain questions would be a way to meet the new requirements and collect the needed information. The letter included specific suggestions for how that could be done.

Instead, on February 23, 2011, the IRS issued a revised Schedule H with an entirely new section that included an additional 80 questions that went beyond what the law required and created onerous and redundant reporting requirements. Tax experts predict the new Schedule H could balloon to 80-200 pages as a result. In April, we requested a meeting in a letter identifying significant and specific concerns with the changes in the revised Schedule, as well as the lack of notice-and-comment rulemaking to implement the new requirements. In a subsequent meeting, the IRS requested detailed line-by-line comments with suggestions for improving the form. On June 13, the IRS announced that the new section would be optional for 2011. On August 24, 2011 we submitted recommendations, as requested by the IRS, addressing each of the requests for information on the revised form and provided an explanation for the recommended changes.

In early January, the IRS issued the 2012 Schedule with no material change and made it mandatory. It is effectively a reissue of last year's form with the same flaws and unnecessary paperwork requirements. The revised Schedule is not compliant with the *Paperwork Reduction Act* (PRA) and, in fact, has never been reviewed by the Office of Management and Budget (OMB) to determine compliance. As a result, hospitals are being denied the protection of OMB review and approval of mandatory collection and reporting obligations required by law.

We have urged the IRS to again withdraw or make the changes to the Schedule optional until the reviews required by the PRA are completed and an OMB approved form is issued. There is still time for the IRS to take action before hospitals begin their 2012 Form 990 filings with the IRS. Our attached May 16 letter to the IRS and the Treasury Department submitted with this Statement reviews the PRA requirements and demonstrates that the revised Schedule H is not compliant with the law. Noncompliance is more than a process issue. The substance of the revised form also fails to meet the PRA requirements that a mandatory collection of information be both necessary and the least burdensome for an agency's proper administration of the law.

We hope that, as the Subcommittee continues its review, you will raise these concerns with the appropriate authorities at the IRS and the Treasury Department. Tax-exempt hospitals remain committed to achieving a reporting system that provides meaningful information about their compliance with the 501(r) requirements and the benefits they provide to their communities. We look forward to working with the Subcommittee to achieve these goals.

Attachment: May 16, 2012 Letter to Emily McMahon, Acting Assistant Secretary (Tax Policy) and Joseph Grant, Acting Commissioner, IRS Tax-Exempt & Government Entities Division (with attachments)

Association for Healthcare Philanthropy

ASSOCIATION FOR HEALTHCARE PHILANTHROPY
Connecting People • Enriching Lives

Statement for the Record
HOUSE WAYS AND MEANS COMMITTEE
SUBCOMMITTEE ON OVERSIGHT
"HEARING ON TAX EXEMPT ORGANIZATIONS"
May 16, 2012

Submitted May 30, 2012 by:
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Chairman Boustany, Representative Lewis, and distinguished Members of the Subcommittee, the Association for Healthcare Philanthropy (AHP) respectfully submits this statement on behalf of the nearly 5,000 development professionals that raise funds for nonprofit hospitals and health care organizations in the United States. We thank you for this opportunity to share our concerns and suggestions regarding oversight of tax exempt organizations. The comments below relate to the philanthropic work of nonprofit hospitals. With the challenges facing health care delivery and the definite need for philanthropic support, it is crucial that the role of the development office and its operation supporting a tax-exempt organization is fully understood so as not to thwart fundraising efforts and erode the public trust of nonprofit health care providers.

Who We Are

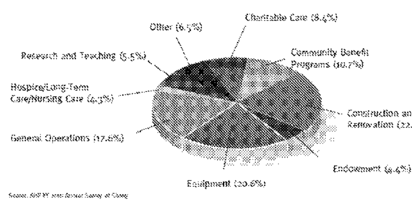
The Association for Healthcare Philanthropy represents the fundraising professionals who are responsible for the management of foundations and fundraising departments that raise funds for nonprofit hospitals and health care providers. Of its nearly 4,000 professional members in the United States, AHP represents approximately 2,000 nonprofit hospitals and health care organizations. Our members' mission is to support local communities through health care facilities and the medical services and the community outreach programs they provide, which contribute to the health of our nation.

AHP's members represent fundraising professionals in all sectors of health care including: community hospitals, medical centers, children's hospitals, specialty hospitals, teaching hospitals and medical institutions, long-term care facilities and hospices.

Health care organizations such as these have come to rely on the generosity of grateful patients and members of the communities they serve to help underwrite operations that can no longer be funded through diminishing operating margins; as well as support charitable care, community benefit programs, facility improvements, medical research, essential equipment upgrades and the acquisition of new health care technologies.

Most, if not all, nonprofit hospital and health organizations routinely factor in to their budgets a significant level of philanthropic support. In FY2010, philanthropic support of nonprofit hospitals and health care organizations reached $8.264 billion in the United States, according to AHP's most recent giving survey report, representing an increase over the prior year, but still almost four percent lower than 2008 giving levels.[i]

USE AND DISTRIBUTION OF FUNDS RAISED IN FY 2010



Introduction

AHP commends Congress' historical and ongoing efforts to encourage charitable giving through tax incentives. America's nonprofit hospitals and the communities they serve have benefited significantly from these provisions. Nonprofit hospitals provide essential services to their communities, maintaining medical departments and offering services deemed unprofitable by many for-profit hospitals, and managing community programs and outreach efforts that make a critical difference in the health of individuals and our communities.[ii]

The intrinsic value nonprofit hospitals play in the health of Americans goes far beyond charity care. As just one example, in the state of Georgia, based on FY2010 IRS Form 990 Schedule H reporting, nonprofit hospitals contributed close to a billion dollars in community benefit. While much of that support was dedicated to indigent and charity care, a sizable portion was for funding of community health programs seeking to proactively address health issues and to reach those individuals most at risk and most in need, and for critical research and training of health professionals.[iii]

The current demands on nonprofit hospitals from the un- and underinsured continue to grow as a result of the recession and prolonged economic downturn. In addition, nonprofit hospitals are struggling to operate under diminishing returns as a result of reduced state and federal funding and ever-mounting capital and operating expenses. In a Moody's Investors Service Special Comment released May 8, 2012, Moody's reports that downgrades for nonprofit hospitals are expected to outpace upgrades in 2012 as nonprofit hospitals face demands to deliver higher-quality service with lower reimbursement rates.[iv]

Philanthropy plays a critical role in the health of our country's nonprofit hospitals, not only as a vital source of direct funding, but also in the ability of hospitals to obtain private financing. Investment firms now consider philanthropic support and a strong fundraising department or supporting foundation a key component in their financial analysis of nonprofit hospitals. [v]

While philanthropic support of nonprofit hospitals and health care organizations is headed back in the right direction, the gains since the recession have come at a cost. Quite simply, it takes more money and more donors to raise the same dollars today than it did prior to the recession, which is why, now more than ever, incentives for giving are essential as they contribute to the health needs of local communities.

Tax-exempt Status

As policymakers review 501(c)(3) tax-exempt health care organizations, AHP would like to share with you a number of critically important challenges facing the not-for-profit health care community and some steps AHP is taking to meet these challenges. It is important to understand the environment that health care fundraisers are currently working within to fully grasp the importance of their institutions' tax-exempt status. Although health care reform is intended to alleviate some of the burden for nonprofit hospitals, most still will exist and present financial challenges.

These challenges fall into three main categories: long-term cultural trends, financial challenges, and regulatory concerns.

First, the long-term trend that permeates a whole range of issues confronting the health care community is the sense of entitlement that has developed over the years with regard to health care delivery. This development in our society creates many stumbling blocks for health care philanthropy – particularly for hospitals, medicals centers, long-term care facilities and hospices.

Patients believe that they have a right to the highest quality of care; that the US has the best health care in the world; that it is far too expensive; and that third parties such as insurance companies are making decisions about health care unrelated to the delivery of good care – decisions that should be made by physicians and nurses. For philanthropy, it raises the question - why donate to such a system?

In addition, few Americans are aware of the differences between for-profit and not-for-profit health care providers or the fact that only 12 to 14 percent of providers are in a for-profit delivery system. Fewer still know that only about one-third of hospitals in the United States have a positive bottom line, while another third are barely keeping their heads above water and the rest are deep in red ink and financially in trouble.

Second, the financial challenges to nonprofit health care providers are many. Some are linked to the fact that many hospitals have postponed capital spending and underinvested in their infrastructure. They need to address deteriorating facilities, but fully 85 percent of hospital chief financial officers say it is going to be more difficult for their organizations to fund capital expenditures in future years.

At the same time, technology's promise, particularly in health care delivery, has created enormous stresses on finances relative to providing quality health care and using cutting-edge technology in providing that care. Expensive technological initiatives need to be undertaken to maintain effectiveness, while operating margins that already are thin threaten to become thinner, placing more responsibility on philanthropy to fill in the gap.

Similarly, the burden of meeting the health care needs of the uninsured, including non-citizens, weighs heaviest on the nonprofit sector, even as revenues from Medicare and Medicaid decline.

In these challenging economic times, charities and nonprofits already are finding it difficult to fulfill their altruistic missions because of reduced donations and resources. Yet, in times of economic trouble, it is charities and nonprofits that do much to augment the work of the federal, state and local government in meeting the needs of the American public through their vital programs and services. In fact, nonprofits currently are being asked to provide even greater levels of assistance.

Conclusion

AHP is confident nonprofit hospitals are providing substantial charity care and community benefits – and many are doing this while not even achieving a 3 percent operating margin. Government officials and legislators need a better understanding of philanthropy.

With that in mind, AHP wants to take the opportunity to educate legislators, the media and the public with regard to nonprofit health care providers and their tax-exempt status. With the challenges facing health care delivery and the definite need for philanthropic support, it is crucial that the role of the development office and its operation is understood fully so as not to thwart fundraising efforts and erode the public trust of nonprofit health care providers.

In summary, AHP members feel that every dollar donated is critical, and we are taking all necessary steps to ensure we achieve the most efficient return on the philanthropic investments of grateful donors and their families. We welcome your questions and ask for a response to these comments as they relate to the philanthropic work of nonprofit hospitals.

Enc.: AHP Statement of Professional Standards and Conduct

Donor Bill of Rights

Association for Healthcare Philanthropy
Statement of Professional Standards and Conduct

All members shall comply with the Association's Statement of Professional Standards and Conduct:

Association for Healthcare Philanthropy members represent to the public, by personal example and conduct, both their employer and their profession. They have, therefore, a duty to faithfully adhere to the highest standards and conduct in:

I.
Their promotion of the merits of their institutions and of excellence in health care generally, providing community leadership in cooperation with health, educational, cultural, and other organizations;

II.
Their words and actions, embodying respect for truth, honesty, fairness, free inquiry, and the opinions of others, treating all with equality and dignity;

III.
Their respect for all individuals without regard to race, color, sex, creed, ethnic or national identity, handicap, or age;

IV.
Their commitment to strive to increase professional and personal skills for improved service to their donors and institutions, to encourage and actively participate in career development for themselves and others whose roles include support for resource development functions, and to share freely their knowledge and experience with others as appropriate;

V.
Their continuing effort and energy to pursue new ideas and modifications to improve conditions for, and benefits to, donors and their institution;

VI.
Their avoidance of activities that might damage the reputation of any donor, their institution, any other resource development professional or the profession as a whole, or themselves, and to give full credit for the ideas, words, or images originated by others;

VII.
Their respect for the rights of privacy of others and the confidentiality of information gained in the pursuit of their professional duties;

VIII.
Their acceptance of a compensation method freely agreed upon and based on their institution's usual and customary compensation guidelines which have been established and approved for general institutional use while always remembering that:

a. any compensation agreement should fully reflect the standards of professional conduct; and,

b. antitrust laws in the United States prohibit limitation on compensation methods.

IX.
Their respect for the law and professional ethics as a standard of personal conduct, with full adherence to the policies and procedures of their institution;

X.
Their pledge to adhere to this Statement of Professional Standards and Conduct, and to encourage others to join them in observance of its guidelines

A Donor Bill of Rights

Philanthropy is based on voluntary action for the common good. It is a tradition of giving and sharing that is primary to the quality of life. To assure that philanthropy merits the respect and trust of the general public, and that donors and prospective donors can have full confidence in the not-for-profit organizations and causes they are asked to support, we declare that all donors have these rights:

I.
To be informed of the organization's mission, of the way the organization intends to use donated resources, and of its capacity to use donations effectively for their intended purposes.

II.
To be informed of the identify of those serving on the organization's governing board, and to expect the board to exercise prudent judgment in its stewardship responsibilities.

III.
To have access to the organization's most recent financial statements.

IV.
To be assured their gifts will be used for the purposes for which they were given.

V.
To receive appropriate acknowledgment and recognition.

VI.
To be assured that information about their donations is handled with respect and with confidentiality to the extent provided by law.

VII.
To expect that all relationships with individuals representing organizations of interest to the donor will be professional in nature.

VIII.
To be informed whether those seeking donations are volunteers, employees of the organization or hired solicitors.

IX.
To have the opportunity for their names to be deleted from mailing lists that an organization may intend to share.

X.
To feel free to ask questions when making a donation and to receive prompt, truthful and forthright answers.

DEVELOPED BY
American Association of Fund Raising Counsel (AAFRC)
Association for Healthcare Philanthropy (AHP)
Council for Advancement and Support of Education (CASE)
National Society of Fund Raising Executives (NSFRE)

ENDORSED BY
(in formation)
Independent Sector

ASSOCIATION FOR HEALTHCARE PHILANTHROPY

National Catholic Development Conference (NCDC)
National Committee on Planned Giving (NCPG)
National Council for Resource Development (NCRD)
United Way of America

Endnotes

[i] AHP FY2010 Report on Giving-US:
http://www.ahp.org/publicationandtools/Documents/AHP_FY2010Factsheet_US.pdf

[ii] *Health Affairs*, "MarketWatch: Making Profits And Providing Care: Comparing Nonprofit, For-Profit, And Government Hospitals," Jill R. Horwitz, May 2005.

[iii] *Georgia Trend*, "Community Benefits," April 2012, http://www.georgiatrend.com/April-2012/Community-Benefits/, Georgia Hospital Association, "3rd Annual Statewide Hospital Community Benefit Report,"
https://publications.gha.org/Portals/4/Document%20Library/2011%20Community%20Benefits%20Report.pdf

[iv] Moody's Investors Service, "Doing More with Less: Credit Implications of Hospital Transition Strategies in Era of Reform," May 8, 2012, http://moodys.alacra.com/research/moodys-global-credit-research--PBM_PBM141731.

[v] Healthcare Financial Management Association, CFO Forum, "Philanthropy: Will It Save Your Operating Budget?" May 29, 2009,
http://www.ahp.org/publicationandtools/News/IntheNews/AHPInNews_2009/Pages/hfma62909.aspx,

Catalogue for Philanthropy

CATALOGUE FOR
PHILANTHROPY

Memorandum

To: Rep. Charles Boustany Jr., Chairman, Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives
From: George McCully, President and CEO
Re: To Assist Your Targeting—The Actual Structure of the Non-Profit Sector, and Where Lost Revenue Is
Date: 15 May 2012

Our organization has examined the Massachusetts IRS Master File of Tax-Exempt Organizations, to identify the philanthropic charities among all other "nonprofits". This is the first detailed study of any state's tax-exempt sector, and it has produced striking discoveries, of value to your Subcommittee's inquiry.

Research Conclusions:

1) Everyone believes that "nonprofit" organizations are "tax-exempt" because they are "philanthropic"—i.e., private initiatives, for public good, relying for revenue on grants and donations (i.e., participating in the philanthropic marketplace). In fact, only about one out of ten (10%) "nonprofits" are philanthropic by that definition.

   Significance: This means that "nonprofit" is very far from synonymous with "philanthropy"; and that public benefit should not be inferred from the mere fact of tax exemption.

2) 75% of "nonprofit" institutions are basically self-serving and self-supporting, and have nothing to do with philanthropy—e.g., condo associations, professional and trade associations, social (including yacht and country) clubs, sports clubs, alumni associations, PTAs, teachers retirement funds, cemeteries, etc. The remaining 25% are: a) indisputably philanthropic (10%—see definition above) or b) somewhere problematically between the two cohorts (15%).

   Significance: Because the 75%—more than 1 million institutions nationwide—are primarily self-serving organizations, their privileges of tax exemption should be questioned. Their reclassification in the tax code would produce substantial revenue.

3) Within the philanthropic cohort (ca. 140,000 institutions nationwide), the vast majority (92% in Massachusetts) are very small organizations, with revenues below $1 million.

   Significance: Among philanthropies, only a small minority—e.g., large universities, hospitals, cultural institutions, national organizations—have large enough revenues to be taxed appreciably. Focus on the biggest ones.

4) The tax code never foresaw tax-exempt institutions with billion-dollar endowments. At that level, annual revenues in capital gains—endowment yields of 12-20%— are larger than any organization can possibly spend, year after year, on institutional growth. Since those surpluses cannot be distributed to private shareholders, they can only be paid out in salaries for top executives and/or plowed back into endowment—creating a positive-feedback loop that balloons endowment beyond practical application.

   Significance: Those excess profits, carefully defined, might profitably be taxed.

Conclusion: The Subcommittee would do well to focus on the 75% of non-philanthropic tax-exempt organizations that are basically self-serving and of questionable public benefit; and on the very small number of very large philanthropic organizations that are profit-making.

Institutional Identification:

The *Catalogue* began in 1997 as a collaborative project of about 20 leading foundations, corporations, and individual donors across Massachusetts, to increase our charitable giving through donor education. We originated the national Generosity Index (1997-2006), which ranked states according to the disparities of their ranks in income and giving, and an annual high-end *Catalogue for Philanthropy* (1997-2007) mailed every November to 200,000 affluent homes statewide. We played a leading role in doubling Massachusetts giving, from $2 billion to $4 billion, in only four years (1997-2000), on an investment of $2 million. With the onset of the Recession we turned our attention to creating the *Massachusetts Philanthropic Directory*, which launched in 2011 (http://www.philanthropicdirectory.org), a complete, systematic, analytical, on-line, *Directory* to all the philanthropic charities in the Commonwealth. We shall extend this system nationwide over the next several years.

Cause of Action

STATEMENT FOR THE RECORD

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

May 16, 2012

Hearing on Operations and Oversight of Tax-Exempt Organizations

1100 Longworth House Office Building
Chairman Charles W. Boustany Jr., MD (R-LA)

Mary Beth Hutchins
Communications Director, Cause of Action

Thank you, Chairman Boustany, for the opportunity to submit this statement for the record to the Committee on Oversight and Government Reform at the U.S. House of Representatives. My name is Mary Beth Hutchins and I am the Communications Director at Cause of Action.[1] Cause of Action is a nonprofit, nonpartisan organization that uses public advocacy and legal reform strategies to ensure greater government accountability and protect taxpayer interests and economic freedom.

One of ways Cause of Action ensures accountability in the federal government is requesting investigations when we see a potential of waste or fraud of taxpayer dollars. Given the recent indication by the Internal Revenue Service (IRS) that it is investigating the abuse of charitable organizations and deductions, we requested that the IRS investigate the Alliance of Californians for Community Empowerment (ACCE), and want to offer you the information we have uncovered about this organization as you consider the oversight of tax-exempt organizations.[2]

GENERAL PRINCIPLES OF FISCAL SPONSORSHIP

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[1] WEBSITE, CAUSE OF ACTION, *available at* www.causeofaction.org.

[2] Paul Streckfus, *Email Update 2012-31*, EO TAX J., (Feb. 17, 2012), *citing* IR-2012-23 ("IRS examiners continue to uncover the intentional abuse of 501(c)(3) organizations, including arrangements that improperly shield income or assets from taxation and attempts by donors to maintain control over donated assets or the income from donated property. The IRS is investigating schemes that involve the donation of non-cash assets -- including situations in which several organizations claim the full value of the same non-cash contribution. Often these donations are highly overvalued or the organization receiving the donation promises that the donor can repurchase the items later at a price set by the donor. The Pension Protection Act of 2006 imposed increased penalties for inaccurate appraisals and set new standards for qualified appraisals.")

As the IRS has stated, a "fiscal sponsorship" occurs "when one or more charities choose to financially support another charity or nonexempt project."[3] According to Gregory Colvin, a leading exempt organizations attorney who is counsel to the Alliance of Californians for Community Empowerment ("ACCE"), the rebranded California ACORN chapter,[4] these arrangements "typically arise when a person or group (we will call this a project) wants to get support from a private foundation, a government agency, or tax-deductible donations from individual or corporate donors," and "[b]y law or preference, the funding source will only make payments to organizations with 501(c)(3) tax status."[5] Fiscal sponsorships have also been known as "fiscal agents," but practitioners disagree on the proper nomenclature.[6]

A fiscal sponsorship relationship can be effectively and lawfully utilized in a variety of situations where a person or group intending to engage in charitable activities wishes to attract tax-deductible contributions without having official exemption by the IRS under § 501(c)(3) of the Internal Revenue Code.[7] For example, "[f]iscal sponsorship is often temporary, used for that period before a new organization obtains its own tax exemption. Other variations occur when a small 501(c)(3) group needs a larger 501(c)(3) organization to manage its financial affairs or seeks IRS classification as a public charity based on its relationship with the sponsor."[8]

While the IRS has yet to produce concrete guidance on the issue, it has indicated approval of fiscal sponsorships by 501(c)(3) organizations only if certain conditions are satisfied. Specifically, a 501(c)(3) organization is allowed to accept tax-deductible funds on behalf of a non-501(c)(3) entity if the following three conditions are satisfied:[9]

1. The project being carried out by the non-501(c)(3) organization is "in furtherance of [the 501(c)(3)'s] own exempt purposes";

2. The 501(c)(3) organization "retains control and discretion as to the use of the funds";

3. The 501(c)(3) organization "maintains records establishing that the funds were used for section 501(c)(3) purposes."

The IRS has provided examples of appropriate uses of fiscal sponsorships:

1. C, an individual, desires to start a tutoring program in the inner city but does not have sufficient resources or the sophistication needed to apply for tax exemption. C submits a grant application to X Community Foundation for financial support for the tutoring program. X approves the grant,

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[3] 94 TNT 71-46.

[4] Matthew Vadum, *ACORN's California Makeover*, AMERICAN SPECTATOR, (Jan. 21, 2010), *available at* http://spectator.org/archives/2010/01/21/acorns-california-makeover.

[5] GREGORY L. COLVIN, FISCAL SPONSORSHIP: 6 WAYS TO DO IT RIGHT, 3 (1993) [hereinafter "COLVIN"].

[6] *Id.* For clarity, we will refer to such arrangements as fiscal sponsorships.

[7] TAX ECON. CHAR. GIVING § 3.02

[8] COLVIN, *supra* note 5 at 4.

[9] Rev. Rul. 68-489, 1968-2 C.B. 210.

establishes a fund called the C Fund, and solicits contributions for this fund. X is C's fiscal sponsor.

2. X community foundation approaches S Private Foundation soliciting for C's fund. S makes a grant to X designated for the C Fund. S, in the instrument of transfer, gives X full control over the investment decisions concerning the grant and full discretion in determining how much and when distributions from the fund will be made.

3. X Community Foundation receives a grant request from Z Charity. X reviews and approves the request. X establishes the Z Fund, and solicits contributions for this fund.

In each of the above situations, X acts as a fiscal sponsor; notice that in the second situation, S, a private foundation, is relieved of exercising expenditure responsibility because it gave X full control over the grant's income and corpus.[10]

MISUSE OF FISCAL SPONSORSHIP

Several legal experts have opined that fiscal sponsorship can be misused by organizations wishing to skirt various Federal laws. For instance, such arrangements can be used as a "passthrough, or conduit, or laundering arrangement where the (c)(3) is really doing no more than receiving money from a donor or foundation and passing it on to a person or an organization that does not have (c)(3) status."[11] John Edie, a leading nonprofit tax attorney, described a fiscal agent as a "laundering agent," and added, "[i]f you're going to use a fiscal agent, to me you're saying, 'Well, I'm going to launder the money through somebody.'"[12]

According to Lee Sheppard, an editor at *Tax Analysts*, "[a] fiscal agent is a money laundry. People who want to finance projects that would not, if separately incorporated, have a charitable purpose often form an exempt organization . . . to act as a conduit[ ] for the money used to finance the project so that its backers can claim a charitable deduction."[13] Sheppard noted that "fiscal sponsorship . . . is a common practice, and one that the IRS should shut down."[14]

Even Gregory Colvin, a leading proponent of fiscal sponsorship relationships, has voiced concerns over their misuse: "[i]f the control mechanisms are not administered properly, [a fiscal sponsorship arrangement] can collapse into a 'conduit' or 'step transaction' in which the IRS will disregard the role of the sponsor and declare that the funding source has, in effect, made a payment directly to a non-501(c)(3) project."[15]

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[10] 94 TNT 71-46.
[11] COUNCIL ON FOUNDATIONS, TOP TEN WAYS FOUNDATIONS GET INTO TROUBLE (2008), *available at* http://www.washingtongrantmakers.org/s_wash/images/client/TopTenTrouble.pdf.
[12] *Transcript of the Winter ABA EO Committee Meeting: Panel Six: The Use and Misuse of Fiscal Sponsorship Arrangements*, 7 EXEMPT ORG. TAX REV. 570, 571(1992).
[13] Lee Sheppard, *Charitable Money Laundering*, 8 EXEMPT ORG. TAX REV. 645 (1993).
[14] *Id.*
[15] COLVIN, *supra* note 5, at 28.

Distressingly, fiscal sponsorships can and have been used as conduits for political activity. I.R.C. § 501(c)(3) prohibits (c)(3) organizations from engaging in political activity.[16] However, the IRS itself has recognized the potential for misuse of fiscal sponsorships, particularly by using a 501(c)(3) organization as a conduit for an improper transaction, and has provided potential examples:

1. X, a philanthropist, wants to give to Z, an individual who is poor. X knows that a transfer directly to Z lacks the necessary public benefit to be considered charitable. X would not be entitled to a charitable tax deduction. To avoid this result, X donates money to Y Community Foundation with instructions to distribute it to Z. Y has no discretion as to the distribution of the funds. Here, Y is nothing more than a conduit. X is not entitled to a deduction.

2. C, a private foundation, wishes to support a nonexempt charitable project. (A nonexempt project, as used in this context, is a charitable activity of an organization that does not have an IRS determination letter.) C does not want the burden of exercising expenditure responsibility, but wishes to maintain continuing supervision of the project. C gives the money to Y Community Foundation after Y has agreed that C will maintain continuing control and that the money will be used solely for the project.

3. S, a fledgling organization, is struggling to maintain public charity status. T, a wealthy donor, wants to give S a large contribution. If T gives it directly to S, the contribution will be subject to the two percent of total support limitation and S would fail the public support test. To avoid this, T "earmarks" the money for S and runs it through the Y Community Foundation. Y has no discretion but to distribute the money to S.

In the preceding three examples, Y Community Foundation has no control over the donations. Y is acting as a mere conduit in a transfer between the donor and the ultimate recipient. The donor and the recipient are the only beneficiaries in these transactions.[17]

According to Professor Frances Hill, 501(c)(3) organizations can be attractive for political donors because of the tax deduction they provide. She wrote, "the most likely [corporate-candidate] conduit, and the one offering the greatest benefits, is a 501(c)(3) organization that is absolutely prohibited from supporting or opposing candidates for public office."[18] As Professor Hill noted, 501(c)(3) organizations are attractive due to lax reporting standards: "Because 501(c)(3) contains the absolute prohibition, 501(c)(3) organizations are not subject to the tax reporting requirements imposed on other 501(c) organizations by 527 and they

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[16] *See* I.R.C. § 501(c)(3) (1986) (providing that an organization qualifies for exemption only if it "does not participate in, or intervene in (including the publishing or distributing of statements) any political campaign on behalf of (or in opposition to) any candidate for public office.")

[17] 94 TNT 71-46.

[18] Frances R. Hill, *Corporate Philanthropy and Campaign Finance: Exempt Organizations As Corporate-Candidate Conduits*, 41 N.Y.L. SCH. L. REV. 881, 927 (1997).

are not required to register with and report to the FEC."[19] In other words, a donor wishing to engage in political activities could funnel his money through a 501(c)(3) fiscal sponsor to a third organization and still potentially receive a tax deduction for his contribution.

<u>ORGANIZATIONS IN CAUSE OF ACTION'S INVESTIGATION INTO FISCAL SPONSORSHIP</u>

The Alliance of Californians for Community Empowerment (ACCE) is either a non-exempt organization or a 501(c)(4) exempt organization and Community Partners is a 501(c)(3) charitable foundation that acts as ACCE's fiscal sponsor. As we show herein, Community Partners may have laundered money on behalf of ACCE. Of the $712,938 in grants given by Community Partners to other organizations in fiscal year 2010, $447,495, or approximately sixty-three percent of grant expenditures, was awarded to ACCE, purportedly for "California Alliance Summer 2010 Voter Engagement Programs" and an "Education and Training Program."[20]

ACCE is a self-professed community organizing "non-profit" organization that fights for "social, economic, and racial justice."[21] While fiscal sponsorships are legal, it is not legal for a 501(c)(3) organization, such as Community Partners, to give any money to an organization that engages in political activity. Moreover, it is not legal for a 501(c)(3) organization to give such a substantial portion of their grants in fiscal year 2010 to an organization that lobbies. With 63% of its grants for the fiscal year 2010 being sent to a single organization that may engage in activities outside the bounds of the Internal Revenue Code's (IRC) tax exemption rules, Community Partners should lose its 501(c)(3) tax-exempt status. Additionally, if ACCE is a 501(c)(4) organization – which Community Partners did not indicate on their 2010 Form 990 and Cause of Action has been unable to verify – it must lose its 501(c)(4) tax-exempt status as well due to the overt political nature of the organization.

Additionally, the Applied Research Center (ARC), an affiliate of the Association of Community Organizations for Reform Now (ACORN),[22] served as a fiscal sponsor of the Alliance of Californians for Community Empowerment.[23] While ACCE has previously posted its tax information on *Guidestar.org*, identifying itself as a 501(c)(4) social welfare organization,[24] ACCE no longer has its tax-exempt information publicly available. Instead, a 501(c)(3), the ACCE Institute, located at the same address as ACCE, is identified on *Guidestar*, although no Form 990 is available.[25]

We are concerned ARC might be improperly fiscally sponsoring ACCE, which does not appear to be engaging in (c)(3)-exempt activities. To illustrate this concern, ACCE has recently

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[19] *Id.* at 927-928.
[20] *Infra* note 22.
[21] Mission Statement, "About," Calorganize.org, last accessed Feb. 24, 2012, *available at* http://www.calorganize.org/about.
[22] *See* ACORN Affiliate List, *available at* http://www.conservative.org/wp-content/uploads/2010/07/ACORN-Organizations.pdf.
[23] *See* FORM 990, APPLIED RESEARCH CENTER, at 2, *available at* http://www.guidestar.org/FinDocuments/2010/942/759/2010-942759879-0783f452-9.pdf.
[24] *See e.g.* Business Entity Search, California Secretary of State Website, *available at* http://kepler.sos.ca.gov (search "Alliance of Californians for Community Empowerment") (Entity Number: C3238528).
[25] *See* GUIDESTAR WEBSITE, *available at* www.guidestar.org ("ACCE Institute" in search).

posted a job opportunity announcement online looking for a "Political Field Director" to "support candidates and issues that reflect our memberships values[.]"[26] Moreover, ACCE is a member of Catalist, a data-based organization which helped elect President Obama in 2008.[27] According to the 2009 Catalist report on member activities, "Obama did better where more progressive registration and persuasion work occurred[.]"[28]

Under the Internal Revenue Code a 501(c)(3) may not direct a "substantial part" of its funds to lobbying and political activities. However, sixty-three percent of the money Community Partners granted to all organizations went to ACCE, nearly two-thirds of its grants, which certainly appears to meet the burden under the IRC. It is clear, then, that Community Partners is primarily used as a conduit to shuffle tax-deductible donations to an organization that may engage in both lobbying and political activities, in violation of the law for tax-exempt organizations.

If Community Partners is found to have granted nearly two-thirds of their granted funds for fiscal year 2010 to ACCE and ACCE is found to be either a political organization or engaged in lobbying, then Community Partners should lose its 501(c)(3) tax-exempt status, and ACCE should lose its 501(c)(4) tax-exempt status, if it is still registered with the IRS as such an organization.

Cause of Action respectfully requests that the Committee consider the misuse of fiscal sponsorship by ACCE and Community Partners as you consider the IRS oversight of tax-exempt activities. Thank you for your consideration of our views and investigation. We would be pleased to provide the Committee with any further information the Committee requests.

Sincerely,

MARY BETH HUTCHINS
COMMUNICATIONS DIRECTOR

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[26] Job Description. Political Field Director/Coordinator, Alliance of Californians for Community Empowerment (ACCE) (Posted Feb. 13, 2012), *available at* http://www.idealist.org/view/job/FH4sbCn2BPFP/.
[27] *See* "Our Client List." CATALIST WEBSITE, *available at* http://catalist.us/clients.
[28] *See* REPORT, AGGREGATE ACTIVITIES OF PROGRESSIVE ORGANIZATIONS IN 2008: COMPILATION OF DATA FROM CATALIST SUBSCRIBERS (Summer 2009) *available at* http://causeofaction.org/wp-content/uploads/2012/05/Catalist-after-action-report.pdf.

Charity Navigator

CHARITY NAVIGATOR

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May 15, 2012

The Honorable Charles W. Boustany Jr., M.D.
U.S. Representative, Louisiana's 7th Congressional District
1431 Longworth House Office Bldg
Washington, DC 20515-1807

Dear Representative Boustany,

I write today to commend you for your efforts to protect donors and to ensure that Americans' charitable dollars reach the recipients that need them the most. Charity Navigator, America's best-known donor advocate, has long called for more oversight of the philanthropic sector and as such would be delighted to support your committee's efforts.

As you may know, Charity Navigator, www.charitynavigator.org, is the most relied upon charity rating service in the country, if not the world. With over 3 million users and roughly 5 million visits to our site last year alone, our service is estimated to impact roughly $10 billion in donations annually. We have an unparalleled position as the leader in providing free, easy to access, and readily understandable information that helps donors in making their charitable giving/social investment decisions. Not content to rest on our success, we are developing a more robust and comprehensive approach to evaluating charities. This new rating tool, termed CN 3.0, incorporates several important elements beyond the financial ratios that make up the core of the current rating system. Specifically, CN 3.0 is a three-dimensional charity rating system that evaluates each charity based on its (1) financial health, (2) accountability & transparency and (3) results reporting.

I recently learned of about your May 16 hearing on Tax Exempt Organizations and that it will be the first in a series of hearings on this topic. I respectfully submit that the success of your hearings would be enhanced with the participation of Charity Navigator. As a charity rater and donor advocate, we provide a unique viewpoint. So, if we can be of any assistance in your efforts to bring additional accountability and transparency to charitable sector, whether it is by providing testimony at one of the hearings, by providing you with expert analysis and data about the charitable sector, or by simply serving as an unbiased sounding board for your ideas, I hope you will not hesitate to contact me. I can be reached at kberger@charitynavigator.org or 201-818-1288.

Again, I thank you for your commitment to protecting the most generous people in the world, the American charitable givers. I wish you well.

Sincerely,

Ken Berger
President & CEO

Charity Navigator is a 501 (c) (3) nonprofit organization under the Internal Revenue Code and does not accept any contributions from any charities we evaluate.

CharityWatch

May 15, 2012

Attn: **Chairman David Camp, House Committee on Ways and Means**
Re: **Hearing on Tax-Exempt Organizations**
From: **Daniel Borochoff, President of the CharityWatch**

CharityWatch (www.charitywatch.org), a rating and evaluation organization dedicated to helping donors make more informed giving decisions, offers the following comments on redesigning the IRS Form 990.

1. CharityWatch calls for public disclosure of the names and EINS of foreign grantees on the Form 990.

CharityWatch strongly believes that nonprofit organizations should be required to publicly disclose the name and EINs of foreign grantees. It is very wrong that tax-exempt organizations can distribute hundreds of millions of dollars of aid, in many cases the vast majority of their budgets, and leave the public entirely in the dark about what specific products were donated and what organizations, if any, received them.

An accountability black hole exists with respect to how charities are allowed to report international aid distributions on their tax forms. When a charity makes a grant or distributes aid within the U.S. worth $5,000 or more it is required to disclose the name and address of the organization that received it on its IRS form 990 Schedule I. However, a charity distributing international aid is allowed in its public disclosures to hide the name and address of the foreign recipient and only disclose the major region of the world, for example, Africa, South America, or Europe, where it is distributed. Such aid is described by charities in only very general terms such as "medical supplies," "household & educational items," or "building materials." This lack of disclosure is very convenient for any charity that wants to exaggerate the value of its foreign grants, particularly if aid is in the form of donated goods or gifts-in-kind (GIK) because it knows there are no public records that an independent watchdog or donor can use to determine whether its valuation of an in-kind grant is reasonable or was even received by the reported recipient.

For example, one charity reported an international grant of over a million dollars in medical supplies and water purification systems on IRS form 990 Schedule I, which is ordinarily used to report grants to organizations in the United States. Because the grant recipient's name and EIN number were reported we had a rare opportunity to attempt to verify an international GIK grant. Upon contacting the organizational grant recipient we found out that it had not received the grant and had never heard of the charity that claimed to have made the donation.

To understand more about how many major charities have been taking advantage of the lack of disclosure of international grants to wildly overstate their work (by nearly 2,500% in the case of one charity), please read CharityWatch's recent articles, *The Alice in Wonderland World of Charity Valuation*, at http://charitywatch.org/articles/valueinwonderland.html, and *View Through the Looking Glass*, at http://charitywatch.org/articles/FoodforHungry_Valuations.html. This is is a serious matter because it allows groups that overstate in-kind international grants to appear to be more efficient and attractive to donors than groups that more reasonably and honestly report their values, thus causing a serious misallocation of America's charitable resources.

CharityWatch has questioned the IRS in the past about why it would ask for disclosure of domestic grant recipients but not foreign ones. The response we received from an IRS official was that charities were concerned that this information could lead to terrorist attacks against a charity or its grant recipients. CharityWatch appreciates that some charities operate in dangerous areas such as in Iraq or Somalia where it might be advisable to conceal the identity of grant recipients. But if a charity is providing aid to organizations in Japan, Haiti or other non-terrorist hotbeds, CharityWatch believes public disclosure of recipient organizations should be required.

It is important that the decision regarding the disclosure of international grants not be based solely on the wishes of nonprofits and their associations. Nonprofits, like for-profits, want to avoid public scrutiny even if it helps to keep them honest and operating well. If the IRS were to ask nonprofits whether they thought the entire IRS form 990 should be abolished, many would readily say yes. Charities could come up with many reasons to eliminate the form 990 such as record keeping and reporting burdens, how the information could be misconstrued, etc... So it is understandable that many nonprofits endorse eliminating a schedule of their international grants, even if doing so is not in the public's best interest.

The U.S. government requires charities that receive funding from USAID to plaster aid boxes with a red, white and blue logo and the words "USAID from the American People" when operating in many areas, including the dangerous border between Pakistan and Afghanistan. Surely, this is more dangerous to aid workers than grant disclosures on a charity's tax form that are not even publicly available on the internet until a year or more after the fact. An anti-American terrorist or violent aid thief is far more likely to learn of a U.S. charity's presence in an area from its very publicly visible operations or by following foreign aid workers after they arrive or leave from the airport or other transportation hub, than from a charity's tax form disclosure of its prior year grants.

The fact that we live in a dangerous world is not a legitimate reason to allow nonprofits to conceal all of their international grants. This line of reasoning could lead to nondisclosure of grants to domestic universities, community centers, youth camps and other places where terrorist events have occurred. Nonprofit organizations that operate in potentially dangerous places both in the U.S. and abroad take precautions such as hiring private security to protect workers and program participants. Many international charities receive protection from the U.S. military or local police. Other charities decide that it is too dangerous to work in some hot spots. Required disclosure of international grant recipients could even serve to decrease terrorism funding. A nonprofit that is unwittingly providing aid to a charity that is operating as a terrorist front organization could more easily be discovered if the names of its grantees are reported on form 990.

The overall benefits of sunlight on the international activities of charities far outweigh the small chance that a terrorist act would be committed because of a tax form disclosure that a U.S. charity is operating in their country. Rather than giving a blanket exemption for nonprofits to avoid all disclosure of its international grantees, we should look to USAID's example and grant exceptions only in cases where a clear terrorist or other threat to a charity exists. It is vital that we do not allow the fear of terrorism to destroy the accountability and transparency of our nation's charities.

2.CharityWatch calls for the enforcement of IRS reporting rules with regards to the disclosure of domestic grants.

Lack of disclosure is not just a problem with foreign grantees, but also domestic ones, even though it is in clear violation of IRS reporting rules. CharityWatch is finding more and more poorly performing nonprofits getting away with avoiding disclosure of basic information about their domestic grants, as required by IRS reporting rules. For instance, some charities will report the total amount of claimed domestic grants on the "Other expenses" line of the IRS Form 990, Part IX, "Statement of Functional Expenses," rather than on the "Grants and other assistance to governments and organizations in the US" line, as a way to avoid disclosing what they are actually distributing and what groups are the recipients or grantees.

CharityWatch is very concerned that some charities are getting credit on their tax forms for distributing huge amounts of undisclosed, useless stuff. Failure to enforce proper reporting of grants, both domestic and foreign, allows charities to avoid the kind of scrutiny necessary to keep them honest and accountable.

3. CharityWatch calls for more disclosure with respect to compensation of charity officers, directors, trustees, and key employees.

The IRS's 2008 redesigned Form 990 and subsequent revisions have been very helpful in providing watchdogs like CharityWatch and the broader public with more detailed information on charities' financial activities. We appreciate the opportunity to provide the House Committee on Ways and Means with input on a very important disclosure that we believe is central to maintaining donors' confidence and trust. Current IRS rules allow charities to hide from the public certain payments made to a nonprofit's individual officers, directors, trustees, and key employees (ODTKEs). We believe this is wrong on several fronts and hope that the House Committee on Ways and Means will help close this accountability gap in its revisions to the current tax Form 990.

Under current Form 990 reporting rules, charities are required to break out compensation paid to each individual officer, director, trustee, or key employee. Schedule J provides for additional compensation disclosures of highly paid ODTKEs. On schedule L charities must report other transactions between the charity and its ODTKEs, including loans to or from the organization, grants to close family members of ODTKEs, as well as excess benefit transactions between the charity and its ODTKEs. Such disclosures of compensation and related party transactions are vitally important to keeping charities and their executives honest by deterring those who have significant control over a nonprofit from using it for personal benefit. Those who might organize a charity primarily for personal gain are also deterred by these reporting requirements which highlight for public scrutiny the transactions between a charity and the people who control it.

Unfortunately, IRS reporting rules still allow for a major lapse in transparency with respect to compensation of a charity's ODTKEs. Under current rules, ODTKEs can receive certain payments from their charity without such payments being reported as compensation to the individuals who received them. For example, the president of a charity might receive $300,000 in salary and retirement benefits from his organization annually. Such compensation is required to be broken out in Part VII of the Form 990, and reported in even greater detail on Schedule J. If this charity executive, rather than receiving compensation directly from the charity, instead sets up a for-profit company and receives this same amount of compensation in the form of consulting payments to his company, such compensation is not uniformly required to be broken out as salary or benefits to this individual officer on the charity's tax form. Instead, the charity is allowed to hide such payments to individual ODTKEs by reporting them as lump sums paid to the consulting company. Allowing nondisclosure of such compensation to individuals simply because payments were made indirectly is at best arbitrary, and at worst deprives the public of the information it needs to determine whether the total compensation paid to any individual ODTKE by their charity is reasonable for the services provided.

Lapses in compensation reporting that amount to loopholes are not helpful for maintaining donors' trust in the sector. Such lapses are also highly unfair to those charities and charity executives who are transparent about compensation in their financial reporting to the public. It is not fair that the president of one charity can brag about taking zero salary from his nonprofit while receiving large payments through his consulting or fundraising company, when the president of another charity has his feet held to the fire by donors for honestly reporting his individual salary on the charity's tax form. Under such a system, otherwise honest charities may feel pressured to hide compensation from the public so they are not unfairly compared to other charities that may, in fact, pay higher compensation to their executives but are not required to break it out. It is necessary to level the playing field by requiring charities to report total compensation paid to individual ODTKEs, regardless of whether such compensation is paid by the charity directly as salary and benefits, or indirectly through outside companies.

Donors are at times too focused on what they perceive as the high levels of compensation received by some charity executives. We at CharityWatch try to put charity executives' salaries in perspective for donors who may not understand that nonprofits compete with the private sector for qualified employees and must offer reasonable compensation relative to the skills, education, and level of experience required for a specific position. Such scrutiny from donors motivates some charity executives to come up with creative ways to hide their compensation. While we understand that it is not always comfortable or easy to justify to donors why a high level of compensation may be appropriate for a specific ODTKE, this should not preclude the public from knowing the amount of tax subsidized dollars used to pay an individual charity executive.

An improved rule requiring charities to disclose all compensation paid to any individual ODTKE should require little additional effort by well-run organizations that already track personnel costs internally. Any charity with good governance practices is concerned about giving the appearance of a conflict of interest when it hires a company that employs or is owned by one of its ODTKEs, and therefore regularly monitors such transactions. The governance and management practices of charities that do not keep detailed records or regularly monitor personnel costs will be improved by an IRS disclosure rule that requires them to do so.

Charities already keep detailed records of employee compensation to meet reporting requirements for federal and state employment tax, workers' compensation and other insurance, and Form 990 disclosures. They also keep track of payments made to independent contractors, consulting companies, professional fundraisers and others for Forms 1099 and 990 reporting purposes, as well as to comply with state level solicitation rules. The recordkeeping and reporting burden a charity might incur to provide the public with a breakout of a charity executive's total compensation is minimal relative to the benefit that comes from giving donors and taxpayers the information they need to hold charities accountable for their dollars.

We thank you for giving CharityWatch an important forum for commenting on these issues. We hope the House Committee on Ways and Means will seriously consider supporting our suggested improvements in the redesign of the IRS Form 990 with regards to the disclosure of international grants and ODTKE compensation, and encourage the IRS to better enforce its requirement that nonprofits disclose their domestic grants.

Sincerely,

Daniel Borochoff
President
CharityWatch

Supplemental Sheet: Contact Information

The above comments should be attributed to Daniel Borochoff, President of CharityWatch.

Further questions or comments can be directed to:

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CharityWatch
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Community Catalyst

Testimony of Community Catalyst
submitted to the
Subcommittee on Oversight of the Committee on Ways and Means,
U.S. House of Representatives

Hearing on Tax Exempt Organizations

May 30, 2012

Submitted by
Jessica L. Curtis, JD
Director, Hospital Accountability Project
Community Catalyst
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Community Catalyst appreciates the opportunity to submit written testimony to the Subcommittee on Oversight of the Committee on Ways and Means of the United States House of Representatives. In particular, we thank Chairman Charles W. Boustany Jr. for calling this hearing to examine the operations and oversight of tax-exempt organizations.

Community Catalyst is a national, non-profit consumer advocacy organization dedicated to ensuring quality, affordable access to health care for all. We work with state advocacy partners and a variety of other stakeholder groups including hospitals in approximately 40 states on a variety of different issues related to health care, focusing on vulnerable groups such as seniors, low-income children and families, immigrants, racial and ethnic minorities, and people living with chronic illness and special health care needs.

For many years, Community Catalyst has worked collaboratively on a range of issues with non-profit hospitals, critical institutions for our health care safety net. As part of this work, we have advocated for strong community benefit programs. Along with our state partners, Community Catalyst worked on the development and implementation of state laws related to community benefit programs and individual hospital facility agreements, studied existing state laws and standards, and developed tools to enable community groups to collaborate with hospitals and others on community benefit issues.

In addition, we worked closely with Members of Congress in calling for the new requirements in Schedule H and creating 26 U.S.C. § 501(r) for tax-exempt hospitals. The provisions in 501(r) strengthen the requirements around what non-profit hospitals must do to meet their community benefit obligations.

Community Catalyst strongly concurs with Chairman Boustany's statement that it is important that the IRS have the information it needs to ensure tax-exempt organizations are operating in furtherance of their charitable purpose and maximizing benefits provided to the community. This is precisely why we believe the new Schedule H reporting requirements are so important and why additional transparency measures in 501(r) are also vital and need to be implemented expeditiously.

As recent press accounts, such as those appearing in the *The New York Times*,[1, 2] *Charlotte Observer*,[3] and *St. Paul Pioneer Press*,[4] make clear, the current practices of at least some non-profit hospital facilities are failing to meet this standard. Schedule H and the new requirements in Section 501(r) are designed to remedy this by requiring facility level reporting on financial assistance and community benefit, public disclosure of what assistance is available, development of a community benefit plan in consultation with the community and establishing standards for billing and collection actions. We firmly believe these new provisions are an integral part of ensuring much-needed transparency and accountability for non-profit hospitals.

The Importance of Schedule H

The data requested in the revised Schedule H serves an important function: it gives policymakers and the public a clearer picture of the value individual tax-exempt hospitals bring to their communities. Each year, local, state and federal governments forego billions of dollars in tax revenues with the understanding that tax-exempt hospitals are providing care to financially needy members in their communities. While we have worked with many dedicated hospital professionals who have used community benefit resources innovatively and effectively to improve access to care for vulnerable populations, many hospitals lag behind. Non-profit hospitals should demonstrate how their tax exemptions are clearly benefitting their communities. We believe reporting individual hospital data works to hospitals' benefit, as well, enabling them to show the value they bring to communities in a particularly difficult time for local, state and federal budgets.

In 2008, the IRS reformed Form 990, including introducing Schedule H for tax-exempt hospitals. One of the guiding principles of those changes was to enhance transparency about hospital organizations' operations, providing the IRS and others, including the communities served by tax-exempt hospitals, comparable information about the ways hospitals choose to conduct their business. From a community perspective, Part V, Section B builds on this goal by providing invaluable information about individual hospital practices: information about the way local hospital facilities, as opposed to hospital systems, choose to serve their communities. The communities served by individual hospitals within a hospital system are likely to differ significantly with regard to economic status, unmet health needs and resources, cultural and linguistic preferences, and priorities. It follows that the need for financial assistance, billing and debt collection, and community benefit programs will also differ across communities. Hospitals, including those that are part of larger systems, should take these factors into consideration and use them to tailor policies to meet the unique needs of their local communities. The information found in Part V, Section B is unique because it provides communities with unprecedented insight into their local hospitals' practices. This information, we note, is not repeated elsewhere in Schedule H, and certainly not to the level of detail found in Part V, Section B.

Research has shown that the information requested in Part V, Section B regarding financial assistance, billing and debt collection is simply not consistently available to hospitals' community members and to patients in need, despite the hospital industry's assertions to the contrary, and especially without active government oversight.

Moving forward, we strongly encourage the IRS to retain Part V, with some improvements, and require all hospital facilities to report it. Including this data in Schedule H reporting will provide a valuable -- and otherwise unavailable – baseline of qualitative and quantitative data about hospital performance. Hospitals have had ample time to come into compliance, even without additional guidance, and should be able to answer the questions found in Schedule H. Delaying the reporting requirements could unintentionally keep communities and individual consumers from gaining timely information about financial assistance programs and fair billing requirements.

The New Requirements of Section 501(r)

Financial Assistance

Though tax-exempt hospitals may face additional reporting and may need to adjust their policies to comply with the requirements of 501(r), we should never forget that the brunt of the burden of inadequate financial assistance, billing and community benefit practices falls on consumers. A

March 2012 report from the Centers for Disease Control and Prevention (CDC) found that, in the first six months of 2011, one in five people were in a family struggling to pay a medical bill, with one in ten reporting their family carried medical bills they were unable to pay at all.[5] As this data suggests, medical billing and debt collection practices do not solely affect the patients who received treatment, but the economic well-being of their families and greater communities. Hospital bills can be particularly devastating: on average, uninsured families can afford to pay only 12 percent of the total amount hospitals charge for a hospital stay.[6]

Because Section 501(r) requires hospitals to make their financial assistance policies publicly available and work with patients to determine whether they qualify, it can offer peace of mind to the millions of Americans stuck in precisely the position described by CDC who are uninsured or underinsured due to job loss, inadequate insurance coverage, chronic illness, and other circumstances beyond their control.

For many individuals, hospital financial assistance programs are the only viable link to health care, but reliable information about them has been difficult to come by in many communities, despite assurances from industry stakeholders to the contrary. Without this information, communities have no real gauge for understanding the value their hospitals bring, and individual patients lack timely access to information that would help them seek necessary care without incurring medical debt. Section 501(r) addresses this by requiring hospitals to report uniform information about their financial assistance programs.

Community Engagement

Solid community benefit practices, which include forthright public reporting on hospital practices and decision-making and meaningful community engagement, encourage a stronger, smarter, more flexible use of health care resources that remove barriers to care at the local level. The new requirements that hospitals engage community members and public health experts in researching, developing and implementing a community health needs assessment and plan incentivizes hospitals to "swim upstream"—that is, to collaborate with other providers, experts and community members to address the issues that lead to poor health and drive improper emergency room use. These programs can ultimately help hospitals and communities drive down burgeoning health costs for *all* payers and improve community health.

Fair Billing and Collection Practices

The term "reasonable effort" for determining eligibility for financial assistance in the context of a hospital's debt collection practices needs further definition. We believe that having strong, uniform, fair financial assistance policies and upfront notification procedures - as described above - is both wholly "reasonable" within the meaning of the law and necessary to achieve its aims of protecting consumers from avoidable medical debt.

In addition certain debt collection activities should be prohibited outright.[7] For example, patients who qualify for financial assistance or are eligible for public programs such as Medicaid should be exempted from debt collection activity. In general, hospital debts should not be referred to collection agencies or reported to credit bureaus until the patient is screened for financial assistance or public programs. Practices such as selling patient debt to third parties or charging interest on outstanding patient debts should be prohibited outright. Many collections practices create tremendous hardship for families, with long-lasting effects that spill over into the financial well-being of whole communities.

In sum, we believe that the reporting requirements in Schedule H and the new requirements of Section 501(r) will go a long way toward ensuring non-profit hospitals are fulfilling their tax-exempt purpose and maximizing community benefit. However, we also believe that to be effective, the provisions of 501(r) need to be clarified through regulation. In 2010, Community Catalyst and 66 other organizations from across the country sent comments to the IRS that outlined the most critical protections that belong in 501(r) guidance.[8] The health care advocacy organizations that signed the letter all believe that we must improve access to quality care, strengthen relationships between hospitals and communities, and alleviate burdens caused by medical debt. Nothing that has occurred in the intervening years has caused us to change our views.

Thank you.

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[1] Silver-Greenberg, J., *New York Times*, "Debt Collector is Faulted for Tough Tactics in Hospitals," April 24, 2012. http://www.nytimes.com/2012/04/25/business/debt-collector-is-faulted-for-tough-tactics-in-hospitals.html?_r=4&pagewanted=all

[2] Bernstein, N. *New York Times*, "Hospitals Flout Charity Aid Law," February 12, 2012. http://www.nytimes.com/2012/02/13/nyregion/study-finds-new-york-hospitals-flout-charity-rules.html?_r=1&nl=todaysheadlines&emc=tha2

[3] Alexander, A. and Raynor, D., *Charlotte Observer*, "Hospital Suits Force New Pain on Patients," April 23, 2012. http://www.charlotteobserver.com/2012/04/23/3193509/hospital-suits-force-new-pain.html

[4] Snowbeck. C., *St. Paul Pioneer Press*, "Minnesota AG Blasts Fairview's Former Medical Debt-Collection Firm for Aggressive Tactics." http://www.twincities.com/ci_20468315/attorney-general-report-calls-medical-bill-collector-overly

[5] Centers for Disease Control and Prevention. *Financial Burden of Medical Care: Early Release of Estimates from the National Health Interview Survey, January – June 2011*. March 2012.

[6] Chappel, A. Office of the Assistant Secretary for Planning and Evaluation, Office of Health Policy, Department of Health and Human Services. *The Value of Health Insurance: Few of the Uninsured Have Adequate Resources to Pay Potential Hospital Bills*. May 2011. http://aspe.hhs.gov/health/reports/2011/ValueofInsurance/rb.pdf.

[7] California, Connecticut, Massachusetts, Washington and New Jersey are among the states that have already taken steps to prohibit hospitals from engaging in some of the practices we discuss.

[8] Community Catalyst, Letter to IRS Commissioner Ingram and Director Lerner Regarding Notice 2011-39, New Requirements for Tax-Exempt Hospitals, July 21, 2010. http://www.communitycatalyst.org/doc_store/publications/IRS_Sign-on_Letter_RE_Nonprofit_Hospitals_with_sign_ons.pdf

Credit Union National Association

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BILL CHENEY
President & CEO

May 16, 2012

The Honorable Charles W. Boustany, Jr. MD
Chairman
Subcommittee on Oversight
Committee on Ways and Means
United States House of Representatives
Washington, DC 20515

Dear Chairman Boustany:

On behalf of the Credit Union National Association (CUNA), I am writing in response to a letter you received from the Independent Community Bankers of America (ICBA) that requested you hold a hearing on the "growing tax-exempt credit union sector." CUNA is the largest advocacy organization in the United States, representing nearly 90% of America's 7,300 state and federally chartered credit unions and their 95 million members. We recognize that the credit union tax status is not the subject of your hearing today; however, the ICBA letter contains inaccurate and misleading assertions regarding credit unions that deserve a response.

The banks assert that "credit unions are becoming harder and harder to distinguish from taxpaying banks with which they compete." However, the structural difference between credit unions and banks has not changed since credit unions' inception in the United States more than 100 years ago, and the practical differences between credit unions and banks have been enhanced by the events of the last several years. As the economy recovers from the greatest financial crisis since the Great Depression, credit unions are now, more than ever, a critical alternative for consumers and small businesses seeking access to affordable financial services.

As you know, credit unions are member-owned, not-for-profit financial cooperatives; because of this structure, the Attorney General in 1917, and later Congress, granted credit unions an exemption from federal income tax which has been in effect since their inception, and which has been reaffirmed several times, including in 1935, 1936, 1937, 1951, and 1998. Over the years, credit unions, like other financial intermediaries, have evolved and have innovated; however, the structure, which is the bedrock of Congress' rationale for the tax exemption, has remained unchanged. Credit unions exist today, as they did more than 100 years ago, as financial cooperatives, and their not-for-profit, tax-exempt status helps to assure that they fulfill their role of providing viable choices in the financial marketplace. This cooperative structure sets credit unions apart from other financial services providers.

In recent years, credit unions have distinguished themselves from banks even further. The for-profit financial services sector was responsible for the greatest financial crisis since the Great Depression, requiring taxpayers to provide banks a significant amount of assistance through the Troubled Asset Relief Program (TARP). In April, the Special Inspector General of TARP released a quarterly report regarding TARP operations and oversight, and it was particularly critical of small bank business lending, noting that taxpayers are still owed $118 billion from TARP, including $15 billion owed by small banks, and many of which banks have missed quarterly payments.[1] However, the American Bankers Association reports "[an industry] net income of $26.4 billion in the fourth quarter [of 2011], an increase of $4.9 billion (23.1%) from a year earlier.... Almost two-thirds of all institutions (63.2%) reported improved earnings, and many institutions were profitable (81.1%)."[2] If the banking sector is making so much money, why are banks not repaying their obligations to taxpayers?

Credit unions did not cause the financial crisis, and did not need a taxpayer-funded TARP bailout to survive. One of the reasons that this has been the case is that the not-for-profit credit union ownership structure is fundamentally different than the for-profit bank ownership structure. Credit unions generally operate in a more conservative manner, taking fewer risks with their members' money than banks may take with their stockholders' investments. For credit unions, the goal is not to make a profit for shareholders, but rather provide affordable financial services to their members. As a result, credit unions have proven to be safe and sound financial institutions, which have endured financial crises from the Great Depression to the Great Recession without needing a taxpayer bailout, in clear contrast to the for-profit banking sector.

The ICBA also notes that the credit union tax status has received a budget score; however, their letter cites a private-sector analysis which is significantly higher than any government score. Regardless, the analysis cited by the ICBA and the various government assessments fail to take into consideration the fact that most credit union income is passed through to credit union members as "dividends" on which those members pay taxes; or the fact that Americans receive considerable benefit from having credit unions in the market place. When looking at all the facts, it becomes crystal clear that the benefit of having credit unions in the marketplace under their current tax treatment outweighs the cost to the government.

Virtually every American benefits from the credit union tax exemption, whether or not he or she belongs to a credit union. We estimate the annual benefit to communities to be more than $10 billion, compared to the approximately $1 billion score the exemption has recently received. These benefits manifest themselves in several ways - in lower interest

[1] Department of Treasury. Special Inspector General for Troubled Asset Recovery Program Quarterly Report to Congress. April 2012. 29.

[2] American Bankers Association. Condition of the Banking Industry. Fourth Quarter 2011.

The Honorable Charles W. Boustany, Jr. MD
May 16, 2012
Page Three

rates and fees than for-profit banks charge, in higher credit union rates of return on deposits, and in a focus by management and the Board of Directors on the member/owners, as opposed to shareholders. Even those consumers and small businesses that do not belong to a credit union benefit from the credit union tax exemption because the presence of credit unions in a market motivates banks to keep their rates and fees competitive.

If the credit union tax exemption were eliminated, the ability of millions of American consumers and small businesses to rely on a system of financial cooperatives for affordable access to mainstream financial services would be jeopardized. While the challenges Congress and the administration face with respect to the budget are significant, any proposal to tax credit unions represents poor public policy that would undoubtedly result in negative consequences for savers and borrowers, the most severe of which would be the erosion of a credit union option for millions of Americans. If taxed, a very significant number of larger credit unions are expected to convert to banks and an equally significant number of smaller credit unions would simply liquidate. The remaining credit unions would have to pass the costs of taxation on to their members because they are wholly owned cooperatives, increasing the cost of accessing mainstream financial services.

Taxing credit unions would amount to a gift of tens of millions of customers to the for-profit banking industry at a time when the public is exceptionally dissatisfied with that industry and is actively pursuing alternatives. In 2011, the number of credit union members increased by 1.3 million. The recent credit union growth resulting, in part, from the recent Bank Transfer Day is an indication that Americans want choices besides banks, and the credit union tax exemption helps ensure that they will find affordable alternatives. Inasmuch as there has been no change in the ownership structure of credit unions and credit unions continue to fulfill their mission, as evidenced by their growth and the substantial positive variance in benefits compared to cost, suggestions that the credit union tax status should be altered in any way should be rejected.

On behalf of America's credit unions and their 95 million members, thank you very much for your consideration of our views.

Best regards,

Bill Cheney
President & CEO

Jewish Federations of North America

Testimony of

William C. Daroff
Vice President for Public Policy &
Director of the Washington Office of
The Jewish Federations of North America

House Ways and Means Subcommittee on Oversight

Hearing on

Tax-Exempt Organizations

May 16, 2012

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William C. Daroff
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House Ways and Means Subcommittee on Oversight
Hearing onTax-Exempt Organizations
May 16, 2012

The Jewish Federations of North America applauds the House Ways and Means Subcommittee on Oversight for holding the first in a series of hearings focusing on issues related to tax-exempt organizations, including recent efforts by tax-exempt organizations to design and implement good governance standards, taxpayer experiences with the newly-redesigned Form 990, and recent legislative changes to the tax code dealing with tax-exempt organizations.

Background: The Jewish Federations of North America ("JFNA") is the national organization that represents and serves over 150 Jewish federations and 300 independent Jewish communities in more than 800 cities and towns across North America. In their communities, the Jewish federation and Network volunteers (collectively, the "JFNA System") are the umbrella Jewish fundraising organizations and the central planning and coordinating bodies for an extensive network of Jewish health, education and social services. With thousands of affiliated agencies and schools, the JFNA system is one of the United States' largest and most effective social service providers, serving well over one million clients each year in both the Jewish community and the general population.

Collectively, the JFNA system raises approximately $2.5 billion each year, roughly $1 billion through an annual fundraising campaign and $1.5 billion from planned giving activities. The vast majority of the $1.5 billion raised through planned giving represent contributions to donor advised funds and supporting organizations, often referred to as "participatory funds." These funds are critical fundraising tools for the JFNA system, comprising approximately 60 percent of the over $12 billion in endowment assets held by federations. Annual grants and distributions from such donor advised funds and supporting organization represent 80 percent or just over $1 billion of the $1.25 billion in grants made annually from federation endowment assets. Annual distributions from the federation donor advised funds and supporting organizations normally range from 15 to 20 percent of their combined assets at the prior year-end. In addition, as discussed below, participatory funds provide the JFNA system with the opportunity to regularly interact with donors to strengthen our overall philanthropic mission.

Good governance and Transparency: JFNA firmly believes that good governance policies and ethical practices represent bedrock principles that are essential if nonprofit organizations are to demand public confidence in their operation. We have long advocated for the establishment of good governance procedures through prudent self-regulation rather than the imposition of government mandates of rigid, one-size-fits-all standards. Boards of charitable organizations must institute and maintain policies and procedures to ensure that it manages and invests its funds responsibly. Federation boards of directors and investment committees fulfill a duty of care to make sure that endowment assets are invested wisely and prudently. Along with concomitant duties of loyalty and to minimize costs, investment committee members have fiduciary responsibilities to investigate asset management decisions and develop strategies appropriate for the fund and charity.

Federations follow established good governance procedures that insure proper stewardship of the funds raised within our communities. Such stewardship reaches all levels of operation and includes formalized mission statements, well articulated roles and responsibilities for boards of directors, officers and other key personnel, rigid conflicts of interest policies, preparation and review of tax and accounting forms and statements, among others. We take pride in the system-wide training offered by JFNA to federations in various aspects of operations including implementation of investment procedures that develop asset allocation strategies, prepare and maintain investment policy statements, implement investment strategies, monitor and supervise implementation and apply procedures to control and account for expenses. A variety of governance policies are documented, reviewed and substantiated on a regular basis, by both internal committees and independent outside auditors. Such periodic review includes verification of adherence to written policies and procedures related to investment allocation, conflicts of interest, organizational changes, and due diligence questionnaires, among others. In sum, federation internal governance procedures and oversight are designed to avoid conflicts of interest and ensure transparency in order to preserve financial resources and trust for our community today and in the future.

The Jewish Federations and the Form 990: In the fall of 2007, JFNA provided extensive comments to the IRS regarding the redesign of the Form 990. We applauded the IRS attempts to revise the form to increase transparency of nonprofit organizations through promoting compliance with the tax law and regulations and minimizing reporting burdens where possible. Although we supported the underlying principle that the Form 990, unlike other tax reporting forms, needs to provide meaningful information on the operations and structure of tax-exempt organizations, especially for those with detailed compensation arrangements, related entities, and complex transactions, we did express concern that many tax filers within the JFNA system would face increased reporting and compliance burdens because their size, structure and breadth of activities would require the completion of several of the detailed new schedules that accompany the new core form. In addition, smaller federations and agencies within the system would find that the new form would greatly increase the cost of compliance and add burdensome recordkeeping and data collection requirements. We urged that the IRS carefully balance the benefits from increased transparency that can be achieved through voluntary compliance with the costs from expanding reporting requirements that will be imposed on the nonprofit sector.

As noted above, our comments on the revised Form 990 emphasized our commitment to good government policies implemented through a self-regulatory approach. Specifically, in regard to the governance questions added to the Form 990, JFNA noted that the instructions to form began with the statement that "(a)ll organizations must answer each question in section III even though certain policies and procedures may not be required under the Internal Revenue Code." JFNA has actively supported "good governance" measures for nonprofit organizations for many years and was a major participant in the important work of the Panel on the Nonprofit Sector, organized in response to the recommendations of the Senate Finance Committee staff. Our comments to the IRS reflected our belief that to the extent that certain practices are mandated by federal or state law, it is appropriate that such practices "must" be followed by tax-exempt organizations. To the extent that such practices are recommended to advance ethical and effective behavior, it is appropriate that such principles "should" be followed by such organizations. We suggested that the IRS make clear that certain governance practices and policies listed on Form 990 represented recommendations and were not required by the tax code. We also noted that certain questions that asked for simple "yes" or "no" responses needed to be expanded to provide supporting explanations that could provide the user with a better understanding of the reporting organization's response and behavior.

In summary, JFNA believes that the new Form 990 does provide both the IRS and the general public with additional useful information as the overall operations of tax-exempt organizations. It should be noted, however, the overall compliance burden and related professional costs for preparation and review have risen significantly for virtually every organization within the JFNA system. Because of the added complexity of data collected, as well as the sensitivity of matters contained on sections of the revised form, many federations have created separate committees tasked with a detailed review of the new Form 990. We continue to work with the IRS to refined portions and schedules of the Form 990. For example, we recently raised the question of duplicative reporting of foreign grants by domestic organizations that make non-earmarked grants to other domestic organizations that can ultimately be granted overseas with the IRS. We appreciate the cooperation that we have received from the agency in consideration of our ongoing to minimize unnecessary or burdensome reporting on tax-exempt organizations.

Recent legislative changes on tax-exempt organizations: The Pension Protection Act of 2006 ("PPA") provided significant new rules for donor advised funds and supporting organizations. As noted above, these participatory funds are essential fundraising tools for the JFNA System and have been a vital source of the health, education and social service programs of agencies of our agencies. In addition to providing financial resources for critical human services in the local Jewish and general communities, these charitable vehicles also advance the values and goals of the JFNA System through nurturing relationships between Jewish philanthropists and federation lay and professional leadership, building leadership and social capital in the Jewish community, establishing priorities that consider the future needs of the Jewish community, and reinforcing the positive perception of the federation as a philanthropic partner within the larger community.

Many of the provisions contained in the PPA provided needed statutory definitions and operational rules for participatory funds as well as a penalty tax framework that can be applied to discourage unwarranted acts of self-dealing. However, JFNA continues to believe that it is in the public interest to provide incentives for donors to contribute assets to vehicles in which a public charity maintains ultimate supervision and control, such as is the case with participatory funds.

We are exceptionally proud that agencies within the JFNA System employ the highest ethical standards of self-regulation in governance and operation of participatory funds and regularly share expertise with other charities and policy makers outside the Jewish community on a variety of charitable giving issues. To help federations meet these high standards, appropriate rules and best practices were set forth in two separate JFNA publications, Donor Advised Funds: A Guide for Jewish Federation Endowment Professionals, and Handbook on Supporting Foundations, for use by the JFNA System. These publications have been revised to reflect the new requirements of the PPA.

JFNA believes that well-administered donor advised funds and supporting organizations that have policies and procedures in place to assure that qualified grants are made and impermissible material benefits to donors are not present greatly adds to overall tax administration. This oversight function performed in federation planned giving and financial departments throughout the country is an important component of the overall tax compliance system that operates in concert with the goal of furthering philanthropic endeavors.

We need to note however, that this oversight function does not come without cost. Virtually every federation now faces increased costs in administering their grant-making function from participatory funds. To prevent an unwanted chill on the philanthropic endeavors of donor advised funds and supporting organizations, it is essential that charities that administer such funds not be burdened with unnecessary procedures and requirements when they accept gifts, approve grants or make distributions in the normal course. In this regard, we have met with representative from the Treasury Department and the IRS on several occasions to urge that rules and regulations interpreting the PPA provide bright-line tests for donor advised funds that could be easily understood by donors and readily administered by fund managers and grant recipients. This clarity would improve compliance as well as foster philanthropy. For example, we continue to urge that Treasury and the IRS make it clear that donor advised funds are not permitted to make a grant if the donor to the donor advised fund is receiving more than an incidental benefit in return for such grant and that an impermissible benefit for purposes of the donor advised fund provision is the same as a benefit that would preclude a donor to a public charity from meeting the definitional requirement for a charitable deduction under Internal Revenue Section 170 for such contribution.

Summary: JFNA supports the efforts of the Subcommittee on Oversight to assure that tax-exempt organizations fulfill their mandate to the public. We support efforts to assure that such organizations meet the highest standards of good governance and transparency. We will continue to work with the IRS to balance the goals of increased reporting without imposing unnecessary or "one-size-fits-all" rules as it pertains to the Form 990. In addition, we will continue to work with the Treasury and the IRS to assure that the implementation of rules interpreting the PPA permit participatory funds such as donor advised funds and supporting organizations to continue to be vibrant vehicles for philanthropic giving.

I thank the committee for the opportunity to present this testimony. If you have any questions regarding this submission, please feel free to contact William C. Daroff, Vice President for Public Policy and Director of the Washington Office at 202-736-5868 or william.daroff@jewishfederations.org or Steven Woolf, senior tax policy counsel at 202-736-5863 or steven.woolf@jewishfederations.org

National Association of Federal Credit Unions

May 15, 2012

The Honorable Charles Boustany, Jr. MD	The Honorable John Lewis
Chairman	Ranking Member
House Ways and Means Committee	House Ways and Means Committee
Subcommittee on Oversight	Subcommittee on Oversight
U.S. House of Representatives	U.S. House of Representatives
Washington, D.C. 20515	Washington, D.C. 20515

Re: Hearing on Tax Exempt Organizations

Dear Chairman Boustany and Ranking Member Lewis:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association exclusively representing the interests of our nation's federally chartered credit unions, I write today in advance of tomorrow's subcommittee hearing and in response to the recent false propaganda of the various banking trade associations. Credit unions are in a unique position to reach traditionally distressed areas across the country, they and their 94 million member-owners welcome the opportunity to disarm desperate arguments the banking trades have fabricated in an attempt to extend Congressional oversight hearings to credit unions.

As you know, not-for-profit credit unions have been statutorily exempt from corporate federal income taxes since 1934. Today, nearly 94 million Americans rely on their local credit union to meet their financial service needs. Despite what the banking trades may want you to believe, the institutional framework credit unions operate within is vastly different from that of banks and thrifts. Credit unions are not making daily $2 billion trades like the mega-banks. Credit unions are not-for-profit member-owned cooperatives. Every dollar earned at credit unions is returned to members through enhanced services including lower fees, higher rates on savings and/or lower rates on loans. Simply put, the differences between credit unions and others who operate in the banking sector extend far beyond tax treatment.

The banking trades continue to ignore the fact that many for-profit banks still rely on massive amounts of taxpayer funding in the wake of the financial crisis. Still, record bank failures continue despite the billions in taxpayer dollars from multiple bailouts that the banking industry has taken. According to a report released last month by the Special Inspector General for TARP, **nearly 400 banks still struggle to repay TARP funds with absolutely no exit strategy** on the table. To quote the report, "the status of those banks is one of the major issues facing TARP nearly four years after the financial crisis." This is even after many banks were allowed to refinance their dividends and exit TARP through additional taxpayer dollars as part of the "Small Business Lending Fund" created last September under the guise of job creation. In short, the record bank failures continue even as they receive a government bailout for their government bailout. While the banks are waiting for the next taxpayer giveaway, credit unions continue to do what they have always done – serve those within their field of membership who may otherwise be unbanked.

In addition, the Subcommittee members should be aware that when attacking the credit union tax exemption, the banking industry also conveniently forgets to mention that a large number of banks do not pay corporate federal income taxes because of their Subchapter S status. There are a total of 2,377 Subchapter S banks that avoid federal income taxes today and that number is expected to grow with Congress recently loosening Subchapter S requirements. **What the banking trades don't want you to know, is that the estimated value of the Subchapter S tax break for banks is $2.05 billion for 2010, *which is actually greater* than the estimated value of the entire credit union tax expenditure ($1.27 billion) for FY2010 as included in the President's FY2012 budget message.** Perhaps the real issue should be the unfair advantage over credit unions that our nation's banks get with their Subchapter S tax breaks and multiple bailouts. Given the fact that there are still tax-exempt Subchapter S banks that still haven't paid back millions in taxpayer funded TARP funds, perhaps the Subcommittee should examine the Subchapter S issue further.

In addition, numerous studies have shown that the value of the credit union tax exemption to society far outweighs the nominal revenue that the government would gain from taxing credit unions. While banks argue for the elimination of the credit union federal tax exemption, even the Americans for Tax Reform (ATR) has said that, "…any tax imposed on credit unions would have a direct impact on Americans' pocketbooks. Credit unions often charge lower loan rates than banks, distribute billions of dollars in dividends to their members and, by virtue of their competitive position, reduce costs for people who do not do any direct business with them." In terms of the total number of people impacted, **the elimination of the credit union tax exemption would be one of the largest tax increases in our nation's history.**

It is with the above concerns in mind that NAFCU would like to reiterate that removing the credit union tax exemption would have a disastrous impact on working-class Americans, especially those who are unable to obtain credit from profit making mega-banks and those struggling to regain economic footing after the most devastating financial meltdown since the Great Depression.

Thank you for your attention to this important matter. If we can answer any questions or provide additional information, please do no hesitate to contact me or NAFCU's Vice President of Legislative Affairs, Brad Thaler, at (703) 522-4770.

Sincerely,

B. Dan Berger
Executive Vice President, Government Affairs

cc: Members of the Committee on Ways and Means

National Council of Nonprofits

Statement of the National Council of Nonprofits

Before the
Subcommittee on Oversight
House Committee on Ways and Means
Hearing on Tax Exempt Organizations

May 16, 2012

The National Council of Nonprofits welcomes the Subcommittee's inquiry into the nonprofit community's efforts to design and implement good governance standards.

America's community-based charitable nonprofits have long been dedicated to earning and maintaining public trust. They understand that whether people are seeking assistance from nonprofits or contributing their time or money to them, the public feels more comfortable supporting nonprofits that demonstrate principles of sound and ethical practice. As the Subcommittee will learn during this hearing, the story of the sector's commitment to earning and maintaining public trust is remarkable.

At the outset, we note that while the Subcommittee has invited testimony from large institutional nonprofits such as hospitals and universities, the vast majority of America's charitable nonprofits are small to midsized local community-based groups. More than 95 out of 100 (95.9%) of charitable nonprofits have income under $5 million, and almost 9 out of every 10 charitable nonprofits (89.1%) have income of less than $1 million.[1] That same 95.9% of these community-based charitable nonprofits took in less than 10% (9.5%) of the entire revenue for charitable nonprofits. By comparison, only 2.5% of charities had income of more than $10 million each.

The types of organizations among the vast majority of charitable nonprofits with revenues less than $5 million cover a broad spectrum of activities at the local level in communities in every congressional district. They range from domestic violence shelters, community theatres, and recreational groups, to religious congregations, food banks, and preschool programs. They include independent groups, as well as local chapters and affiliates of large national organizations, be they Boys & Girls Clubs, Girl Scouts, Habitats for Humanity, Junior Leagues, PTAs, United Ways, YMCAs, and countless others.

[1] IRS Exempt Organizations Business Master File, as posted by The Urban Institute, National Center for Charitable Statistics, http://nccsdataweb.urban.org/ (Number of Organizations Filing Form 990).

The commitment to earning and maintaining public trust is exhibited daily by the State Associations of nonprofits. Each of the State Association members of the National Council of Nonprofits maintains written conflict of interest policies for their volunteer board and staff and are committed to modeling good governance in all other ways for the their more than 25,000 charitable nonprofit members. As members of the National Council of Nonprofits, each State Association also agrees as a condition of membership to adhere to the governance practices referenced on the IRS Form 990 or to the even higher standards or principles of practices adopted by that State Association for use by nonprofits in its state. Additionally, integral to their role as leaders and resources for charitable nonprofits in their state, the State Associations of nonprofits offer extensive training throughout the year to volunteer board members and nonprofit employees on topics that reinforce good governance practices.

Starting in 1994 with the adoption of the initial edition of Principles and Practices for Nonprofit Excellence by the Minnesota Council of Nonprofits, a movement began among nonprofit State Associations to identify and promote principles of sound and ethical practice for the nonprofit community, state by state. Over the past two decades, 19 of our State Associations of nonprofits have embarked on a thoughtful process, in conjunction with nonprofit leaders in their states, of identifying and recording guidelines and principles by which nonprofits in their state should operate. Some State Associations have adopted not only principles of practice, but also workbooks and training curricula for use in raising awareness among board and staff members about the principles for good governance that apply to nonprofits in their state. All 37 State Association members of the National Council of Nonprofits offer training throughout the year, in-person and via internet-based technologies, for volunteer board members and paid staff on topics addressing legal, sound, ethical, and accountable operations. Through the State Association's leadership role and work to "build the capacity" of charitable nonprofits in their states, these principles of practice, and associated training programs and other resources are available to countless nonprofits, just as they are to anyone who visits the websites of the State Associations or searches for the phrase: "nonprofit principles and practices."

The following State Association members of the National Council's Network have developed principles and practices programs for the nonprofits in their states[2]:

- Alabama | Standards for Excellence®
- Arkansas | The Arkansas Diamond Standards™
- Colorado | Principles and Practices for Nonprofit Excellence in Colorado
- Connecticut | Principles and Practices for Nonprofit Excellence in Connecticut
- Delaware | Standards for Excellence®
- Illinois | Illinois Nonprofit Principles and Best Practices
- Iowa | Iowa Principles and Practices for Charitable Nonprofit Excellence
- Kentucky | Principles & Practices for Nonprofit Excellence in Kentucky
- Maine | Guiding Principles & Practices for Nonprofit Excellence in Maine

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[2] Links to these and future postings of principles and practices can be found at http://www.councilofnonprofits.org/resources/resources-topic/principles-and-practices.

- Maryland | The Standards for Excellence®
- Michigan | Principles and Practices Guide for Nonprofit Excellence in Michigan
- Minnesota | Principles and Practices for Nonprofit Excellence
- Mississippi | Principles and Practices for Nonprofit Management Excellence
- Montana | Principles and Practices for Nonprofit Excellence in Montana
- Nebraska | Guidelines and Principles for Nonprofit Excellence in Nebraska
- North Carolina | Principles & Practices for Nonprofit Excellence
- Oklahoma | Standards for Excellence®
- Pennsylvania | Standards for Excellence®
- South Carolina | Guiding Principles and Best Practices

In addition to the body of work developed by the State Associations that demonstrates the nonprofit community's embrace of self-regulation, in 2007 the Panel on the Nonprofit Sector (convened by Independent Sector) introduced *33 Principles for Good Governance and Ethical Practice* for use by nonprofits as well as any philanthropic organization as a guide for strengthening effectiveness and accountability. The *33 Principles for Good Governance and Ethical Practice: Reference Edition* provides background on the legal guidance relied on to craft the *33 Principles of Good Governance and Ethical Practice* with comparisons to other standards and systems of self-regulation in the nonprofit sector.

We conclude by stressing that there is no single set of "best practices" that could apply to all nonprofit organizations across multiple states. Charitable nonprofits can range from organizations that are small all-volunteer groups serving a local community to those that employ hundreds of employees and work all over the world. Many nonprofits are regulated by special additional federal, state, and/or local regulations, such as those organizations providing healthcare, food services, interacting with youth, or housing, while many others comply with accreditation standards applicable to their subsector (such as museums and hospitals). Still others choose to follow recognized principles of good practice on a voluntary basis, out of a desire to be soundly operated, accountable, transparent, and ethical organizations.

It is our view that the nonprofit sector is so diverse that a national standard applicable to all charitable nonprofits would not be practical or advisable. Therefore, the State Associations of nonprofits have committed themselves to best governance practices and sound ethical standards by way of their own conduct – by leading by example – and where applicable, by setting the bar in their states to which all nonprofits in their states can strive to excel.

The National Council of Nonprofits, the nation's largest network of nonprofit organizations with more than 25,000 member nonprofit organizations, works through its member State Associations to amplify the voices of America's local community-based nonprofit organizations, help them engage in critical policy issues affecting the sector, manage and lead more effectively, collaborate and exchange solutions, and achieve greater impact in their communities.

National Council of Nonprofits
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The Community Foundation for Greater Atlanta

connecting passion with purpose

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May 18, 2012

RE: Hearing on Tax Exempt Organizations

House Ways and Means Committee

Subcommittee on Oversight, May 16, 2012

Dear Chairman Boustany, Representative Lewis and members of the Committee:

My name is Alicia Philipp and I am the President of one of the nation's largest community foundations, The Community Foundation for Greater Atlanta. We are a philanthropic foundation that holds nonprofit status. Our foundation has more than 700 individual and family donors who have created 1,126 donor-advised funds. In 2011, we accepted approximately $72 million in gifts to new and existing funds with the majority of gifts coming from our donors through their donor-advised funds. In addition, we have several unrestricted, competitive grant-making programs. These funds are distributed among nonprofits in our 23-county metropolitan region.

In 2011, the Community Foundation granted an estimated $73 million to nonprofit and faith-based organizations. These grants are primarily made via donor recommendations through their donor-advised funds, our unrestricted, competitive grant programs and through multiple community initiatives. More than 85% of the $73 million in grants were made via donor-advised funds. Our unrestricted and field of interest competitive grant-making programs prioritize general operating support and nonprofit governance, accountability and transparency. The grants range from small awards to church sponsored food pantries in rural Morgan County to larger grants to organizations such as the Visiting Nurse Health System which provides care medical care to thousands in the region.

I'd like to speak on two issues. First, is my strong appeal that the **IRA charitable rollover be permanently extended and expanded to remove limitations on the age of donors, the size of gifts and the inclusion of donor-advised funds, supporting organizations and private foundations.**

connecting passion with purpose

The Community Foundation
FOR GREATER ATLANTA

In 2011, the pay-out from donor-advised funds at our Foundation was 14%. Reinstating these incentives offers taxpayers enhanced reasons for charitable giving – and is likely to increase those gifts. I do not need to detail for each of you the trials our economic crisis has had on the "least of these" among us. The organizations we fund are universally engulfed with higher requests for services and often from new populations – long-term unemployed, veterans, young adults leaving the foster care system.

Second, I'd like to address the concerns expressed by several members of the subcommittee regarding the tax-advantage position and the lack of regulation upon the nonprofit sector. Historically, the nonprofit sector has occupied the space between individuals, governments and markets. It has served as a platform for our national value of charitable giving and volunteerism. The sector has provided citizens with an organized sphere from which a diversity of social values and individual interests have been honored and directed toward wide social benefit. In exchange, the sector relinquishes its opportunity to be profitable – to build its strengths in the same manner available to our manufacturers, retailers, markets. There are multiple federal and state regulations to monitor this system.

In addition, funders such as the Community Foundation for Greater Atlanta demand a high level of financial stewardship, informed and strong governance from all our grantees. This is one of the methods we employ to provide leadership in the local nonprofit community.

Once again, thank you for the opportunity to share these thoughts with you. Please let me know if I can provide any other useful information for your inquiries in this matter.

Sincerely,

Alicia Philipp

Alicia Philipp

President

MATERIAL SUBMITTED FOR THE RECORD

Questions for the Record:

Ms. Diana Aviv

DIANA L. AVIV
PRESIDENT AND CEO, INDEPENDENT SECTOR
HOUSE WAYS AND MEANS SUBCOMMITTEE ON OVERSIGHT
HEARING ON TAX EXEMPT ORGANIZATIONS
MAY 16, 2012

RESPONSE FOR THE RECORD FOR REP. MARCHANT

Thank you, Mr. Marchant, for your question.

There are a number of principles and improvements we would like to see incorporated into the Form 990. In my written statement I briefly discuss Independent Sector's engagement with the IRS as the agency continues working to improve the Form 990, and am grateful for the opportunity to expand upon that discussion here.

During a public comment period last summer on several issues of concern that had come to the attention of the agency, Independent Sector conducted an online forum to gather input from exempt organizations. The following recommendations are based upon the comments of 220 participants from the nonprofit sector, and were submitted by Independent Sector to the IRS.

Electronic Filing of the Form 990

We support electronic filing of the annual information returns filed by nonprofit organizations because it enhances compliance and transparency, improves oversight and enforcement by the IRS, and provides more timely and accurate information to the public. Congress should amend the Internal Revenue Code to give the IRS authority to expand the scope of returns that are required to be filed electronically by lowering the number of returns that trigger the requirement to file electronically from 250 filed per year to five per year.

Currently only about 30 percent of charitable organizations take advantage of the option to file the Form 990 electronically. While we support expanding the scope of organizations that are required to file electronically, we also believe that more can and should be done to encourage electronic filing. To that end, a group of charitable organizations, led by the National Center for Charitable Statistics at the Urban Institute and joined by Independent Sector, has initiated an effort to better understand and overcome the barriers to filing electronically, and to look for ways to encourage or incentivize additional electronic filing.

We believe that increased electronic filing will improve the quality and accuracy of the data available to the public and for IRS and state regulatory purposes. This will further promote accountability and transparency by exempt organizations, and in the long run save donors, nonprofits and the government time and money.

Reporting Revenue from Governmental Units

Government support has become an enormously important source of revenue for the country's nonprofit sector. Part VIII of the Form 990 should be revised to clarify that government contributions may include grants from contracts. The term "contracts" should be added to Part VIII, line 1e, which identifies the government payments to be included as payments to nonprofits from government for services provided to the public, so that this line of the Form will read as follows: "Government grants, contracts." The word "contracts" should also be included in the several other places on the Form 990 instructions that refer to what should be reported in Part VIII, line 1e, of the form.

This change will make it clear that revenues nonprofits receive from governmental units in the form of purchase-of-service contracts for provision of services to the public, and not just revenue from government grants, should be included on Part VIII, line 1e and not on the line reserved for program service revenue.

Presently, the Form 990 also does not record Medicare and Medicaid payments to nonprofits as revenue received from government. Rather, it directs organizations to record income from Medicare and Medicaid as "program service revenue." As a result, these government payments are lumped together with private fees and payments for service and lose their identity as government support. We believe there are two potential solutions to this issue:

- Change the Form 990 instructions to direct organizations to include their Medicare and Medicaid revenues on Form 990, Part VIII, line 1(e) with other government revenue, rather than on Part VIII, line 2 (a-g), which is reserved for program service revenue;

- Restore the words "Medicare/Medicaid" to Form 990, Part VIII, line 2a, the portion of the 990 Form on which organizations are asked to record their "program service revenue;" include language in the instructions to this portion of the form calling organizations' attention to this line; and include data from this line on 990 files made available to the public through the National Center for Charitable Statistics and IRS data files.

Reporting on Audited Financial Statements

Part XII of the Form 990 should require some additional reporting on audited financial statements for organizations that are required to conduct an audit. We recommend that a line be added to Part XII that asks whether an organization makes its audited financial statements available to the public on its website. Additionally, it would be helpful to ask organizations that have audited financial statements to indicate whether the audit report provided an unqualified, qualified, adverse, or disclaimer of opinion or included an "ongoing concern" explanatory paragraph. If these questions are included, the Form should provide designated space or instruct preparers to use Schedule O for the organization to explain any problems with the audit report.

We also recommend that the Form 990 Instructions make clear that federal law does not require organizations to have financial statements audited unless the organization receives certain amounts in federal government funding, nor does federal law require that the board establish a separate audit committee.

Activity Codes

While the National Taxonomy for Exempt Entities (NTEE) remains the most appropriate system for classification of nonprofit organizations and their program activities, further adjustments in NTEE are necessary to accommodate the full range of exempt activities undertaken by filing organizations.

We recommend that the IRS convene organizations like The Foundation Center, the National Center on Charitable Statistics, and Independent Sector, as well as other organizations and research programs with an interest in and experience with NTEE and other coding systems, to make the appropriate adjustments to NTEE.

Thank you.