

Alliance for *Charitable* Reform

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Commonsense Charitable Reforms We Support

The Alliance for Charitable Reform's overarching goals and principles include:

- **Increase and Expand the Private Philanthropic Sector**
- **Expand Resources Available for Charitable Activities**
- **Value the Important Role of Family Charitable Commitments in America**
- **Improve Financial Transparency and Accountability of Charitable Sector**
- **Enforce and Simplify Existing Laws Before Adding New Laws or Outsourcing the IRS's Oversight and Enforcement Functions to Third Parties**
- **Impose Stricter Penalties on Wrongdoers without Punishing Inadvertent Violators**
- **Avoid a "One Size Fits All" Approach**

The following charitable reforms would further these goals:

Increase Philanthropy and Expand Resources Available for Charitable Activities

- 1. Reduce the net investment income tax on foundations from 2 percent to 1 percent (*passed by the House as part of H.R. 7 – the House version of the CARE Act and in the President's FY'06 budget*).**

Currently, private foundations pay as much as a 2% excise tax on their net investment income each year. Those proceeds, since 1969, were intended for IRS enforcement. In fact, only a very small fraction of those proceeds are used for that purpose while the remainder goes into the general Treasury.

The Alliance supports the House and the President in their calls to roll back the tax so that foundations can use the additional funds for grant-making.

- 2. Enhance incentives that encourage foundations to exceed current targets for grant-making (*proposed in the SFC staff draft*).**

Provide additional incentives to private foundations to make grants by eliminating the tax on net investment income for those entities whose grants levels exceed prescribed grant-making targets will expand the charitable sector – and remove a greater burden from the government for programs and services.

The incentives proposed in the SFC staff draft are a good start and we would encourage Congress to also consider graduated incentives that begin with a 6% payout rate.

3. The Alliance supports restricting certain administrative expenses of private foundations (passed by the House as part of H.R. 7 – the House version of the CARE Act).

The Alliance supports the House-passed proposal that provides objective standards and limits to determine which administrative expenses are allowable for purposes of determining minimum annual payout by private foundations.

ACR supports treatment of the following expenses as allowable for purposes of minimum annual payout:

- Administrative expenses directly attributable to direct charitable activities, grant selection activities, grant monitoring and administration activities, compliance with law, or furthering public accountability of the private foundation;
- The portion of compensation paid by the foundation to certain individuals up to an annual rate of \$100,000, adjusted for inflation;
- Travel expenses – costs of ground travel and all regularly scheduled commercial, coach airfares.

4. Improve valuations of – but do not eliminate -- in-kind property contributions (proposed in the SFC staff draft).

Improper valuation of assets, whether as a result of mistake or otherwise, is one of the most important challenges facing the administration of the Federal income tax system.

Given the importance of non-cash contributions to charities, the Alliance strongly supports these contributions. As a necessary corollary, the Alliance supports efforts to improve the valuation standards that apply to non-cash contributions and the imposition of stiff penalties on appraisers that overstate the value of in kind property.

Enhance and Enforce Existing Law

5. Excise taxes paid by private foundations and fees and taxes collected from public charities should be dedicated exclusively to fund IRS enforcement of exempt organizations.

When Congress first enacted these excise taxes in 1969, the intent was for the proceeds to be used to fund IRS oversight of the charitable sector. Since then only a **small fraction** of those proceeds are used for that purpose.

If inadequate funding of the IRS enforcement capability is the problem, then solve *that* problem by dedicating sufficient proceeds from the current tax to enforcement, as they were intended.

The best way to cure enforcement deficiencies is not to write more laws: but to **vigorously enforce existing laws and regulations.**

Moreover, vigorous IRS oversight is the best deterrent to future wrongdoers. The first step of any meaningful exempt organization reform effort must be to act to assure that adequate funding exists and is used to enforce present law and any enacted reforms.

Alternative funding mechanisms such as other user fees could also be explored *provided* the funds are used for enforcement, not general government operations.

6. Increase Excise Taxes, Sanctions and Other Penalties for Wrongdoers (*proposed in the SFC draft and in the JCT Study*).

Enforce existing laws and, if necessary, strengthen penalties on those found to have violated the law. Penalties should be **increased, imposed and collected**, without punishing inadvertent violators.

Increase first-tier excise taxes and penalties on acts of self-dealing and non-charitable expenditures for wrongdoers.

The Alliance would support increased excise taxes in other areas, such as jeopardy investments, as long as the enhanced penalties are accompanied by clear, “bright-line” tests and definitions.

7. Modify and Simplify the Form 990 series to improve financial reporting (*proposed in the SFC staff draft*).

Efforts are already underway to improve financial reporting through improvements in the Form 990 series. Instead of creating new forms and complex and burdensome new reports, the IRS can and should reform and improve the financial reporting aspects of Form 990/990-PF.

Use the time-honored form 990 series but *simplify* and *improve* it, to give the IRS and donors a clearer picture of funds being received and how they are being expended by charities and foundations.

For example, the Alliance supports improved descriptions of activities being conducted by the organization such as direct charitable programs and activities by private foundations, to permit the IRS and the public to assess the types of program services and activities or unrelated trade or business activities being conducted by the organization.

8. Expand electronic filing of Form 990/990-PF by all charities and foundations and penalties for failure to correctly file (*proposed in the SFC staff draft*).

The IRS recently estimated that under the electronic filing regulations promulgated in January 2005, approximately 10,000 tax-exempt entities would be subject to electronic filing requirements by 2007.

ACR generally supports the initial extension of the electronic filing requirements to the largest of the tax-exempt entities: those with total assets of at least \$100 million for 2005 returns, and of at least \$10 million for 2006 returns.

However, ACR also expresses its concerns about electronic filing and offers these cautionary notes:

- Be certain to establish mitigating provisions for inadvertent errors by smaller organizations if / when electronic filing is extended to *all* filers;
- Be careful that the electronic filing doesn't run counter to the principles of simplification and greater transparency;

- Be certain the IRS is prepared to properly handle and process electronic filing such that the automated systems function as promised.

9. The IRS should utilize its current reviewing capabilities during the five-year advance ruling period before establishing some new or additional ‘initial review’ system.

The IRS already has the tools at its disposal to review the sources of support for broadly supported public charities during the initial five-year advance ruling period;

The IRS already has the capability for reviewing the Form 990s of charitable organizations to ascertain whether the annual expenditures are in keeping with the stated purposes of the organization as described to the IRS by the charity in its Form 1023.

The IRS can and should enforce the existing laws and utilize the tools and information already being provided to the IRS every year to ascertain whether charities are performing in accordance with the law and their mission for which exempt status was granted.

Adding more and more layers of reporting and regulation isn’t going to address a problem of review and enforcement when the information filed with the IRS currently is either being ignored or is not being utilized for its purposes under existing law because of lack of resources.

10. Make tax-exempt entities and their managers subject to penalties for facilitating tax shelter transactions (*proposed in the JCT study and SFC staff draft*).

Charitable and other exempt organizations should not assist others in transactions that serve no purpose other than to avoid federal income taxes. The Alliance supports efforts to require disgorgement of the fee or other income an exempt organization derives from helping others avoid their proper income tax liability, and the imposition of penalties on organization managers who are responsible for authorizing the organization to participate in such transactions.

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The Alliance for Charitable Reform is a project of the Philanthropy Roundtable, a 501(c)(3) tax-exempt organization. The Alliance is proud to represent charitable organizations, including private foundations, and specifically family foundations, as well as public charities.