



# *Opportunities Lost:* Missing the *Point* in the Nonprofit Accountability Conversation

by Rick Cohen

Transparency and enforcement cost money—where it will come from?

**W**HILE THE NONPROFIT LEADERSHIP organizations addressing the issue of nonprofit accountability are clearly serious and sincere, many of us do not hold out much hope that the recommendations that emerge from major industry groupings or the legislation that follows will assuage the problems highlighted in recent public media scandals. Why?

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**RICK COHEN** is the executive director of the National Committee for Responsive Philanthropy ([www.ncrp.org](http://www.ncrp.org)).

First, transparency and enforcement cost money—and in the context of the current federal budget, serious questions have to be resolved about where it will come from. Even accountability-friendly nonprofits have every right to balk at supporting imposed fees and penalties when the foundation excise tax has ended up in the general treasury. Besides, a lot of enforcement occurs at the state level, and no plans are in the works to ensure the various offices of the attorneys general are consistently staffed or funded.

Second, the Independent Sector (IS) panel seems to have chosen as its first phase targets “low-hanging fruit” issues that would generate consensus among panel members. How will they handle the next phase, where the real challenges to the governance of foundations reside and where more disagreement exists? And will there be anyone interested and listening on Capitol Hill by the time the second phase emerges?

### **Oversight, Enforcement, and Transparency Costs Plenty**

Governmental oversight of the nonprofit sector is going to go nowhere without capital infusions giving agencies such as the tax-exempt division of the IRS the wherewithal to carry out even the most basic functions of examining and investigating the voluminous submissions of 990PFs and 990s—never mind any more proactive measures. Despite breast-beating to the contrary, the foundation sector and its nonprofit leadership allies have never—until quite recently—voiced support for a specific linkage of the excise tax, generating well over a half billion dollars a year, to support governmental oversight and enforcement functions. Although they will defensively say that they publicly favored increasing the budget of the IRS tax-exempt division, you won’t find that as a core tenet in the message of the foundation sector’s lobbyists or their annual lobbying pilgrimage to Capitol Hill.

In fact, among the headers of the Council on Foundations’ 2005 “Foundations on the Hill” lobbying day<sup>1</sup> is a listing of legislative issues accompanied by working papers and issue briefs addressing the priority legislative items for organized philanthropy ([www.foundationsonthehill.org/issuepapers.htm](http://www.foundationsonthehill.org/issuepapers.htm)).<sup>2</sup> Keyed to pending legislation, the second topic on the list is the full repeal of the excise tax on private foundations. Originally designed to provide a dedicated resource for IRS oversight and enforcement actions, the tax was delinked from this function (or never adequately linked in the first place) many years ago, making foundations the unique nonprofit institution that is taxed to contribute to the federal treasury.

Until recently, only one national nonprofit leadership group (the National Committee for Responsive Philanthropy, NCRP) has called for the rededication of the foundation excise tax to this function, even laying out a strategy for

reducing and consolidating the excise tax—parceling out the proceeds to IRS, state attorneys general, and nonprofit research and watchdog organizations. In the wake of the Senate Finance Committee brouhaha, the National Council of Nonprofit Associations (NCNA) belatedly endorsed NCRP’s longstanding call to link the excise tax to its original statutory purpose, and now one of the working groups convened by Independent Sector has recommended to IS’s nonprofit panel some targeted use of the excise tax.

### **The Excise Tax: How Much are We Talking About?**

Even during the gloomy stock market days of 2002 and 2003, the excise tax was a \$500 million per year revenue generator. In late 2003, NCRP estimated that a reduction and consolidation of the excise tax to a flat 1% would free up \$140 million for new grantmaking and still leave more than \$350 million to bulk up IRS oversight, to funnel desperately needed resources to state attorneys general, and to fund nonprofit data collection functions currently supported by philanthropic giving at nonprofits such as GuideStar and the National Center for Charitable Statistics.<sup>3</sup> With the revived stock market of late 2004 and 2005, those figures significantly understate what the foundation excise tax could deliver for nonprofit oversight and enforcement plus needed research and data collection.

These recommendations for using the excise tax or finding other resources, such as 501(c)(3) or 990 filing fees, come a little late in the day to promise much. At the same time the IS working group recommendations were published, President Bush’s Fiscal Year 2006 budget emerged, taking the nation along the path of an almost total disappearance of resources for discretionary expenditures within a decade, not counting the costs of the war in Iraq, other potential military engagements, expenditures to fight terrorism, and the Social Security “fix.”

President Bush’s budget does propose more resources for the IRS, but there is little to suggest that it will be devoted to appropriate oversight. The precedent of Fiscal Year 2005 is frightening: the IRS’s new efforts against tax cheats did not focus on corporations or the wealthy, but beefed up efforts aimed at low-income taxpayers filing for the Earned Income Tax Credit (EITC).<sup>4</sup> With the drumbeat of major players blaming small

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nonprofits or the proliferation of nonprofits for the accountability problem in the sector, it is hard to imagine that a pumped-up IRS will aim its tax-exempt enforcement resources at the well-endowed miscreants highlighted in the press.

Facing not only the fast-shrinking pot of federal discretionary revenues, but also the challenge of proposing to the Senate Appropriations Committee the dedication of a general tax revenue like the foundation excise tax to a specific purpose like nonprofit oversight, the Senate Finance Committee proposed a variety of alternatives for financing oversight, as well as a bevy of fees and charges to pay for IRS oversight functions.

Politically speaking, fees and charges are simpler to enact and bypass the Appropriations Committee scum, but they pose two significant problems. First, unlike the excise tax, a motley array of fees and penalties add to the complexity of nonprofit tax compliance<sup>5</sup> and perhaps place the burden on smaller nonprofits that might have less discretionary capital to direct toward fees and charges. Second, once a revenue like a fee or charge (or any new revenue raiser, for that matter) is on the table there is no guarantee that it will be used to pay for functions that benefit the nonprofit sector. Witness the car donation “fix,” whose purported \$2 billion in tax savings was used to help offset the Bush Administration’s \$146 billion corporate tax cut in 2004.<sup>6</sup>

### The State of the States

Many observers believe that the IRS is and should continue to be primarily a tax collection agency, not an instrument for effective enforcement of nonprofit accountability. The nonprofit accountability activism of attorneys general in New York, California, Minnesota, Massachusetts, and Illinois, as well as in other states, makes the case for some people that nonprofit accountability oversight and enforcement, like politics, is local—or state-level—rather than federal.

In the “CARE Act” portion of the omnibus S.6 introduced in the 109th Congress by Republicans Santorum, McConnell, Frist, and Hutchinson, the longstanding pleas of state charity officials are addressed with language authoriz-

ing the IRS to share information with the attorneys general about proposed enforcement actions by the Service against 501(c)(3)s. There is little question that the Independent Sector process will come out in favor of electronic filing of 990s and 990PFs, alleviating state agencies of having to dedicate staff slots to data input clerks.

But the Independent Sector’s working group endorsement of using the foundation excise tax for oversight did not include state charity officials among the potential beneficiaries.

There might be a number of reasons for the apparent diffidence toward state attorneys general:

Some political wits suggest that “AG” stands not only for attorney general, but also for “aspiring governor.”<sup>7</sup> Innuendo abounds that the high-profile charity enforcement activities of AGs such as New York’s Eliot Spitzer and others may be inspired as much by politics as probity.

All told, only about a third of the states possess active charity offices in their AG’s offices or elsewhere that do more than simply address charitable solicitations. Putting the emphasis on the enforcement activism of the state AGs leads to an inconsistent set of state government capacities and even inclinations for dealing with nonprofit accountability issues.

Despite ostensibly supportive statements from nonprofit leadership groups at convenings of the National Association of State Charity Officials (NASCO), the sector has taken a pretty strident stance against most examples of the AG’s activism. While effective in getting movement on the questionable “nonprofitness” of some nonprofit hospitals and insurers in Minnesota, AG Hatch has taken his share of lumps not only for his hospital interventions, but for his critique of the profit-like aspects of the nonprofit Minnesota Public Radio (MPR) controversy.<sup>8</sup> The grumbling about Spitzer’s briefly floated Sarbanes-Oxley type accountability legislation was not limited to New York State, as nonprofits elsewhere fretted that their homegrown AGs might emulate New York’s.<sup>9</sup>

Ultimately, it may be true that assigning the IRS increased oversight and enforcement functions is a non-starter, that the IRS is first and foremost a tax collection agency, not an entity to sniff out and correct nonprofit and foundation



accountability dilemmas. But with such wide variability among the capabilities of states' charity officers, it is difficult to bolster state oversight functions without first building the state oversight infrastructure.

### Sources of Anti-Regulatory Pushback

To some nonprofits and foundations, the panoply of IRS agents, state charity officials, and federal agency contract monitors is enough regulatory oversight to squeeze the life out of anyone. This sentiment is hardly limited to the archconservative side of the political spectrum, but some conservatives are beginning to drive the bus.

It should not come as a surprise that in the conservative policy swing enveloping this nation during the past several years, the drumbeat against regulation in the nonprofit sector has had a right-wing tint. Conservative commentators such as Leslie Lenkowsky<sup>10</sup> have fretted that bolstered regulations might kill the goose that laid the golden charitable egg, and even conservative intellectuals such as columnist George Will<sup>11</sup> have taken aim at efforts to tighten up scrutiny of car donations. Oddly enough, their comments don't sound all that different from some of the sentiments, stated with less animus toward government, by some nonprofit sector leaders aiming to protect their discretionary ability to pay handsome fees to foundation board members and to allow board members and insiders to benefit from ostensibly below-market business services rendered to their nonprofits and foundations.

Foundation leaders know that their industry is tremendously flexible and minimally regulated, allowing for the achievement of great good through philanthropic grantmaking, but permitting a variety of questionable behaviors, self-indulgent expenditures, and even hefty fees for sitting on nonprofit boards, not to mention the clearly objectionable self-enrichment schemes of some of foundation people who clearly embarrass their peers. Overall, foundations seem to have little appetite for regulatory reform, searching instead for self-regulatory mechanisms, relying on the Council on Foundations' stewardship standards to ward off the threat of more muscular government oversight.

Similarly, the Independent Sector panel's first phase panel recommendations generally

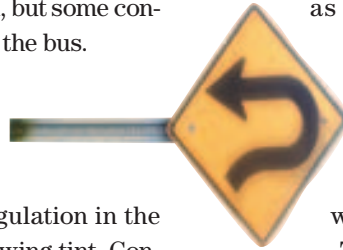
modify the edges of nonprofit accountability with modestly increased excise penalties on inappropriate self-enrichment and tougher sanctions for nonprofits that repeatedly flout registration and filing laws. Joined by commentary from the National Council of Nonprofit Associations (NCNA), the IS panel clearly favors stronger self-regulation by the sector and investment in educating nonprofit board members about their fiduciary duties rather than adding significant brawn to government regulations. If the government did ante up with capacity-building funds, as IS and NCNA advocate and the Senate Finance Committee white paper intimated, one might wonder which national nonprofit organizations would be jostling at the head of the line to help with the expenditures.

The anti-regulatory drums beat loudest from the Philanthropy Roundtable, a foundation association leaning to the conservative side of the spectrum as a counterweight to the mainstream Council on Foundations. Emerging from the Roundtable's criticisms of the Senate Finance Committee's "white paper" recommendations in 2004 is a new organization, the Alliance for Charitable Reform, led ostensibly by well-known tax lobbyist Sandra Swirski of Venn Strategies. Like the Council on Foundations' recruitment of Akin Gump to carry the foundation sector's legislative package on Capitol Hill, replete with major Republican (former Congressman Bill Paxon) and Democratic (Clinton friend Vernon Jordan) leadership, Venn provides bipartisan lobbying muscle for the Roundtable's fight against regulation, with well known Democratic operatives on staff such as former Kerry and Lieberman associate Anne Urban.<sup>12</sup>

The Alliance has reportedly garnered support beyond the Roundtable's conservative foundation supporters with its "concern ... about the threat of potential legislation to every foundation's integrity and freedom to operate."<sup>13</sup> Among the foundation players behind this new coalition are Heather Higgins of the Randolph Foundation, a former co-anchor of a television show with Newt Gingrich, and Daniel Peters of the Ruth and Lovett Peters Foundation, formerly an executive at Procter & Gamble.

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servative think tanks and policy advocates, including the vibrantly anti-regulation Competitive Enterprise Institute, which regularly advocates in favor of the notion “that consumers are best helped not by government regulation but by being allowed to make their own choices in a free marketplace,”<sup>14</sup> language pretty similar to the sentiments of the Philanthropy Roundtable and the Alliance for Charitable Reform when they inveigh against the Senate Finance Committee rumblings.

Foundations, for their part, escape the Independent Sector panel lens with little scrutiny. They get chided for parking money in donor-advised funds (DAFs) at community foundations, though the panel seems to overlook parking spaces other than DAFs favored by foundations reluctant to meet their immediate payout requirements. But the panel clearly decided, before day one, that the issue of foundation payout would not be discussed at all. The issue of foundation trustee fees, probably the most common high-visibility issue in foundation accountability in the press during the past two years, is relegated to the panel’s second phase, suggesting for some misplaced priorities. Ranking right behind trustee fees would be the ability of foundations to use the legal, accounting, and investment firms owned by or associated with their trustees, but that’s perhaps lurking in phase II as well, along with attention to inappropriate foundation expenditures such as Bombardier jets for trustees and Jaguar roadsters for CEOs.<sup>15</sup>

### What is Immediately Ahead?

Maybe we will all be surprised to see the milquetoast quality of the phase I issues and recommendations supplanted by tough-minded outrage and concomitant policy recommendations in phase II of the Independent Sector process. That would be great. But Congress is moving right along. The Senate Finance Committee already has a bill on the docket, the latest resurrection from the dead of the CARE Act, with the longstanding policy target of Independent Sector and many other national organizations of the non-itemizer charitable tax deduction. In Senator Rick Santorum’s new CARE Act (part of S.6), there are provisions for some improvements in charity oversight, including, most

important, the ability of IRS and state charity officers to share information about ongoing investigations of nonprofit wrongdoers. The Committee is probably working up another batch of recommendations aimed at Type III supporting organizations, increased disclosure (and hopefully minimum payout requirements) for DAFs, and tightened regulations on charitable donations of land and easements in the wake of the Nature Conservancy and other scandals.

But where will attention be by the time the hopefully tough-minded phase II Independent Sector recommendations emerge? If CARE moves, which is doubtful, if the S.6-related nonprofit oversight improvements get spun out and adopted, if the Committee moves on some other issues, how much appetite will be left for more attention to the nonprofit issues that are other than low-hanging fruit? As the federal budget lurches ever deeper into deficits, as government spending for critical social needs falls off the radar screen, as the two parties duel over ways to debilitate the Social Security system, it is difficult to imagine that phase II will generate much Congressional traction.

Some nonprofit and foundation leaders will breathe a huge sigh of relief, having outlasted the scandals of 2003 and 2004 at the price of tighter restrictions on car donations, an IRS tax-exempt division slapped awake by Senate Finance Committee hearings, and probably some new regulations concerning penalties for nonprofits that inexplicably forget to file their 990s for years running.

### Endnotes

1. Foundations on the Hill is also sponsored by the Forum of Regional Associations of Grantmakers.
2. The Web site also includes links for the Council’s and the Forum’s comments on the Senate Finance Committee white paper and a summary of presentations made at the Committee’s July 2004 nonprofit roundtable meeting, although not the testimony presented at the Committee’s official June 2004 hearings.
3. NCRP called for a distribution of the \$350 million or more among several targets: 20% to beef up the IRS’s tax-exempt division, 40% to a fund controlled by the IRS commissioner to distribute to state charity offices, 15% for nonprofit research, 15% for nonprofit data collection (like the data collection that the IRS does on



other economic sectors), and the remainder available for IRS special enforcement projects. Cf. Rick Cohen and Jeff Krehely, "Paying to Mind the Store," *Responsive Philanthropy* (Spring 2004).

4. In 2005, the Administration requested a 68.5% increase in its EITC enforcement budget, though EITC represented only 2.8% of the uncollected tax gap (cf. [www.americanprogress.org/site/pp.asp?c=biJRJ8OVF&b=4157](http://www.americanprogress.org/site/pp.asp?c=biJRJ8OVF&b=4157)), and the FY2006 budget request keeps the focus squarely on EITC tax cheats (estimated at one-fourth of EITC filers), as opposed to finding the much larger number of EITC-eligible families who fail to file for this resource.

5. Since the Clinton Administration, the public sector has supported reducing and consolidating (but not eliminating) the foundation excise tax to enhance tax simplification, contrary to a regime of multiple fees and penalties.

6. Rick Cohen, "Begging for Pennies: Nonprofit Leaders Blind to Impact of Proposed Republican Tax Cuts," *Philanthropy Journal* (October 8, 2004).

7. AG Christine Gregoire was elected governor in Washington in 2004; AG Claire McCaskill lost to the son of Republican Majority Whip Roy Blunt for governor in Missouri; former attorney general Jerry Kilgore is running for the statehouse in Virginia; current attorney general Eliot Spitzer is clearly aiming for the New York governor's mansion; Minnesota's Mike Hatch has run in the past and could well do so again; Florida's Charlie Crist is rumored to be a potential Republican successor to term-limited Jeb Bush, etc.

8. In a well-publicized speech in 2002, the Minneapolis Foundation's Emmett Carson criticized Hatch's review of MPR's for-profit catalogue business, Green-spring Co., and the Allina Health System's conglomeration of hospitals, clinics, and nursing homes for finding neither entity engaged in any illegal activities and thereby obscuring rather than clarifying the applicability of nonprofit accountability laws (cf. [cpnl.georgetown.edu/doc\\_pool/Neilsen0107Carson.pdf](http://cpnl.georgetown.edu/doc_pool/Neilsen0107Carson.pdf)).

9. Spitzer's bill calling for nonprofit CEO/CFO/Treasurer verification of annual reports, designation of executive committees and audit committees, controls on self-dealing by audit committee members, etc. never made it out of legislative committee. In late 2004, Spitzer's office decided not to introduce even a modified bill, but to publicize the AG's newfound support for "educating directors and officers of not-for-profit corporations rather than imposing new laws" ([www.legislativegazette.com/read\\_more.php?story=325](http://www.legislativegazette.com/read_more.php?story=325)).

10. Leslie Lenkowsky, "The Not-So-Independent Sector: Is More Regulation Required, or Have We Already Legislated Too Much?" *Philanthropy* (January/February 2005).

11. George F. Will, "Regarding Help to the Fallen, Will Congress Be Pound-Foolish?" *Pittsburgh Post-Gazette* (July 19, 2004).

12. Venn's 2004/2005 client list includes the Philanthropy Roundtable, the Association of Small Foundations, and the National Committee on Planned Giving, in addition to corporate clients such Metropolitan Life, BellSouth, Eli Lilly, and the drug industry's Pharmaceutical Research and Manufacturers Association of America (PhRMA). The foundation sector seems to have been partial to Akin Gump, with former Congressman Bill Paxon recruited for a quarter million dollars by the so-called Foundation Executives Group, a collection of some 20 large foundations united to fight the changes in foundation payout calculations in the Charitable Giving Act of 2003 (H.R.7), and more recently recruited by the Council on Foundations in 2004 to carry the sector's Capitol Hill agenda (the Council also retains other out-of-house lobbyists in addition to its own in-house government relations staff). The Foundation Executives also retained Clark Consulting Federal Policy Group, whose midyear 2004 report counted \$160,000 in fees for H.R.7 lobbying. Clark's relatively recent 2004 client list includes the likes of the Financial Services Roundtable, representing the banking sector, the American Council of Life Insurers, Anheuser Busch, Amarelda Hess, General Electric, the Edison Electric Institute, General Motors, and Akin Gump, among others.

13. See [www.philanthropyroundtable.org/magazines/2005/janfeb/president.htm](http://www.philanthropyroundtable.org/magazines/2005/janfeb/president.htm).

14. See [www.cei.org/pages/about.cfm](http://www.cei.org/pages/about.cfm).

15. Cf. Rick Cohen, "Time to Stop Excusing the Inexcusable: Foundation Trustees Who Play by Their Own Rules," *Nonprofit Quarterly* (Winter 2003).



### Let's Talk!



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