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IRS Needs More Money to Monitor Rapidly Expanding Nonprofit World



Pablo Eisenberg

By Pablo Eisenberg

While the Internal Revenue Service is responsible for overseeing the nonprofit world, it is no secret that the agency has done a poor job in holding nonprofit groups and foundations accountable, preventing abuses, and maintaining a measure of ethical behavior.

Chief among the reasons for this hapless performance is simply the agency's lack of money and people. Effectively monitoring and policing the nation's 1.7 million tax-exempt organizations—1.2 million of which are charitable organizations—would require a vast increase in the budget of the IRS's tax-exempt division. It would also take an increased focus on nonprofit groups by an organization that views itself primarily as a collector of taxes; for many of the tax agency's leaders and employees, nonprofit groups are a diversion from what they see as the IRS's primary mission.

Moreover, the agency's standards and regulations are not clear or tough enough to prevent inappropriate behavior, such as excessive compensation or sweetheart financial deals, nor are the penalties it is willing to impose stringent enough to deter bad behavior.

For at least the past four decades, Congress has refused to increase the budget of the IRS tax-exempt division to a level that would enable it to do its job effectively.

The Tax Reform Act of 1969 levied an excise tax on private foundations, and the money collected was supposed to be used to oversee charities. But that money has never been set aside for that purpose. Instead, the revenue from the excise tax has gone into the general treasury.

For all their posturing and brave talk about holding nonprofit groups more accountable, Sen. Charles Grassley, Republican of Iowa, and his colleagues on the Senate Finance Committee have done little or nothing to push for larger appropriations for the IRS's tax-exempt division by the Congressional appropriations committees. Senator Grassley's public hearings on nonprofit abuses, warning letters to charities, and press statements have not proved sufficient to produce additional resources.

The inability of the IRS to oversee and police charitable organizations properly comes at a particularly difficult time in the nonprofit world's history. During the past 20 years, the number of charities and foundations has almost doubled, accompanied by an increasing number of abuses and scandals.

Those scandals can no longer be papered over or ignored as they were in the past. Growing news-media coverage, especially by daily newspapers, has focused increased attention on the way charities run their organizations.

At stake is public confidence in the charities we support; if it erodes, fund raising will become far more difficult because donors won't trust that their money will be well used.

The charitable world today is plagued by greed, the invasive ethics of "corporatization," and salaries for chief executives that are spiraling out of sight. In some quarters, there are few constraints on abusive activities.

Nowhere is the disorder of the nonprofit world more apparent than in the inflation of CEO compensation. Despite the recession, the budget difficulties of states and localities, and the cutback in services by thousands of charities, the salaries of nonprofit and foundation leaders, especially the large ones, are rising at an alarming rate, often surpassing the inflation rate by a margin of five to one.

Excessive compensation has not been the only problem besieging the nonprofit world. Some charity officials are hiring family members, a practice that, while not illegal, should be rare.

In just the latest of the high-profile scandals, the New Jersey attorney general in September sued the president of Stevens Institute of Technology, in Hoboken, for pillaging the school's endowment; for keeping two sets of books; and for receiving low-interest loans from the institution—some of which were later forgiven—to finance vacation homes.

This state of affairs had been going on for some time, abetted by a board loaded with the president's cronies, say observers. The president announced last month that he would step down, but his resignation does not take effect until July 1 and then he will work under a consulting arrangement at the institution until 2014. Board members say most of the charges by the attorney general were unfounded. But when so many questions have been raised, why was the Internal Revenue Service not taking any action?

In spite of the corruption and irresponsible governance that persist in the charitable world, most nonprofit groups, and their trade associations, don't seem very perturbed about this state of affairs and have done little to seek change.

To keep the vast number of tax-exempt organizations monitored, honest, and accountable, the IRS had a budget of just \$94-million last year.

The staff of the unit that oversees charities and other tax-exempt groups has only 838 employees to handle the oversight of all the nation's nonprofit groups.

Some 355 of those people work to review applications for tax-exempt status. Some 58,590 applications for charity status were approved in 2008 while only 1,240 were denied, a little more than 2 percent. Clearly the application process is not rigorous.

No wonder a new report on the charity application process, conducted by the Stanford University Center on Philanthropy and Civil Society, was called "[Anything Goes.](#)" The tax-exempt unit's office of examinations, which has 461 employees, is responsible for conducting audits and enforcing compliance with tax laws. In 2008 only 2,946 returns of tax-exempt organizations were examined out of a total of 888,412, just 0.33 percent of the total. According to several experts familiar with the IRS, not more than 100 serious audits were carried out in 2008.

The limited capacity of the IRS for oversight is not only startling but also a mockery of the notion of public accountability.

What is even more bewildering is the challenge of doing something about it.

Some observers have suggested that an independent unit, somewhat along the lines of Britain's charity commission, should be created to replace the IRS as the regulator and overseer of the nonprofit world. That might be a good solution, but it is hard to imagine that such a proposal could pass political muster today. It would be wiser to apply public pressure to seeking more money for the IRS's tax-exempt unit.

Another solution would be to amend a proposal the Council on Foundations, an association of grant makers, made to Congress.

It has suggested imposing a uniform annual excise tax on private foundations of 1.33 percent of net investment assets. It could add a stipulation that the entire tax be earmarked for the IRS's tax-exempt division, thereby putting pressure on Congress to demand better oversight of charities.

Regardless of whether such legislation is enacted, it is up to Congress to strengthen the oversight and policing of charitable organizations. Its lack of concern and refusal to act are directly responsible for the lack of openness, accountability, and abuses that characterize today's charities.

It's about time our legislators begin to do their job.

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