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What Congress Can Do to Fight Charity and Foundation Abuses

By Pablo Eisenberg

Recent news-media coverage of foundation excesses and scandals -- including high trustee fees, conflicts of interest, sweetheart financial deals, and inappropriate expenditures -- have raised serious concerns in both the U.S. Senate and the House of Representatives.

What many lawmakers need to understand, however, is that years of indifference and inaction by members of Congress partly explain why the nonprofit world has experienced major accountability problems and why it is under such heavy public scrutiny today. For years, lawmakers have refused to give the Internal Revenue Service the proper resources it needs to oversee and police charities and foundations.

Even if the IRS had more money, more staff members, and better computers to track nonprofit organizations, it has not received much encouragement from Congress to be a tough regulator. Instead, lawmakers have permitted the agency to be permissive and lax in its oversight functions, more interested in protecting wealthy donors and foundations than in assuring that philanthropy is doing what it should to help the nation. What's more, Senate hearings that attacked the IRS for not being consumer-friendly enough did plenty of damage, as the most experienced and highly skilled tax regulators left the agency in frustration or as the result of reorganization brought about by the pressure from lawmakers.

Congress could do a lot to bring greater accountability and integrity to the nation's foundations and nonprofit organizations. Following are the top priorities for lawmakers to act on soon:

- Allocate a significant portion of the revenue from the annual excise tax that private foundations must pay on their net investment assets for use by the IRS and state attorneys general to crack down on abuses by nonprofit organizations and donors.

While the 1969 Tax Reform Act established the excise tax specifically to pay for federal oversight of nonprofit organizations, the revenue has never been used for this purpose. Instead, the money has gone into the general treasury. At least $250-million -- if not more -- of the $550-million or more derived annually from the tax

should be given to the IRS for nonprofit-enforcement activities, with $75-million earmarked for the tax agency to give to the state attorneys general.

At least $25-million should be reserved for conducting research on charities and foundations and to underwrite nonprofit efforts to put IRS reports and information online, such as is done on the GuideStar Web site.

- Place an $8,000 limit on the total compensation any trustee can receive from a foundation. That limit would include fees both for serving on a board and for providing other services rendered to the foundation, such as investment counsel and legal and accounting services.

Trustees on many foundation boards receive compensation. It makes no sense to pay the wealthiest and most highly paid professionals in the United States for the time they contribute to serving on foundation boards, when board members of nonprofit organizations, often low-income, working-class people, receive no compensation for their services. Allowing foundations to pay minimal trustee fees, however, would be useful. That would permit foundations to recruit low-income and middle-income board members who cannot afford to take time off from work for trustee service, thereby encouraging greater diversity on foundation boards.

A ceiling on trustee pay would also prevent trustees from "self-dealing," or reaping undue financial gains from their association with a foundation. The self-dealing provisions of the IRS code are so vague and full of loopholes that they have not only become useless in preventing abuses but actually tend to encourage them. The limits would also put an end to the large number of foundations that appoint trustees who are lawyers, accountants, or other professionals. Trustees cannot both provide services and insure that such services are proper and effective.

- Trustee compensation of any kind should be excluded from the calculation of foundations' payout requirements. Under current law, such payments can be included when grant makers determine whether they have met the federal requirement to distribute at least 5 percent of their assets for charitable purposes.

By excluding trustee compensation from this calculation, foundations would have less incentive to pay board members. They would also have more money to distribute to nonprofit groups.

- Prohibit family members of family foundations from receiving any compensation either as board members or staff members of their foundations.

Family members can always serve on the staff of their foundations as unpaid volunteers, but they should not be paid for their charitable contribution to their own family's philanthropy. That is double dipping, since donors get sizeable tax breaks for putting money into a foundation and should not get any additional financial benefits for their donations.

- All foundations with $1-million or more in assets should be required to issue an annual or, at least, a biennial report to the public. All nonprofit organizations with a budget of $100,000 or more should also be required to issue such reports.

The Form 990 reports submitted to the IRS each year by both nonprofit groups and foundations are not user-friendly, don't provide much information on programs or their impact, and don't shed much light on governance issues.

In the interest of transparency and accountability, charities and foundations should provide regular reports on their activities. The Council on Foundations has been urging foundations to issue such reports, but to date only approximately 2,200 do so. Donors and taxpayers need to know more about how their money is being used.

- Authorize revisions to the Form 990's to provide more information about potential conflicts of interest, special perks such as loans to trustees and staff members, and other inappropriate expenditures.

Currently, foundations are not asked to state the relationship between trustees and the contractors they have hired or the grantees they have supported, nor do they have to provide details about travel, board, and other costs. All nonprofit groups should be required to provide such information.

- Instruct the IRS not to grant charity status to organizations whose mission is to provide political favors and engage in political activity. The tax agency should be especially careful in reviewing applications from organizations created by elected officials, since the potential for donors to expect favors is great.

Just in the past year, two prominent examples show the potential for abuse.

House Majority Leader Tom DeLay, a Texas Republican, and his wife created Celebrations for Children, a charity that will host parties and outings for lawmakers at this summer's Republication National Convention in New York and channel the money to the DeLay Foundation, which supports programs to help abused and neglected children. Setting up charity events at a political convention suggests that the charity is more concerned about influence peddling than helping young people.

In Maryland, Gov. Robert L. Ehrlich, a Republican, has set up at least four nonprofit groups to promote the governor, his agenda, or his administration, *The Washington Post* reports.

- To prevent conflicts of interest, foundations should not invest in businesses in which any trustee has more than a 5-percent ownership interest.

Abuses by grant makers and other nonprofit organizations have shaken the public's confidence in our civil-society institutions. The news media, no doubt, will uncover more examples during the coming months. Leaders of charities and foundations must act now to demand legislative and regulatory changes. Congress must

not squander its opportunity to clean up the nonprofit world.

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