

103

FEDERAL TAX LAWS APPLICABLE TO THE ACTIVITIES OF TAX-EXEMPT CHARITABLE ORGANIZATIONS

Y 4. W 36:103-39

Federal Tax Laws Applicable to the...

HEARINGS

BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
OF THE
COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES
ONE HUNDRED THIRD CONGRESS

FIRST SESSION

JUNE 15; AUGUST 2, 1993

Serial 103-39

Printed for the use of the Committee on Ways and Means



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**FEDERAL TAX LAWS APPLICABLE TO THE
ACTIVITIES OF TAX-EXEMPT CHARITABLE
ORGANIZATIONS**

TUESDAY, JUNE 15, 1993

**HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
*Washington, D.C.***

The subcommittee met, pursuant to call, at 1:10 p.m., in room B-318, Rayburn House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

[The press releases announcing the hearings follow:]

FOR IMMEDIATE RELEASE
FRIDAY, JUNE 11, 1993

PRESS RELEASE #9
SUBCOMMITTEE ON OVERSIGHT
U.S. HOUSE OF REPRESENTATIVES
1135 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-5522

THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN,
SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES,
ANNOUNCES A PUBLIC HEARING TO REVIEW THE FEDERAL TAX LAWS
APPLICABLE TO THE ACTIVITIES OF TAX-EXEMPT CHARITABLE ORGANIZATIONS

The Honorable J. J. Pickle (D., Texas), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will conduct the first of a series of hearings to review administration of, and compliance with, the Federal tax laws applicable to public charities exempt from taxation under section 501(c)(3) of the Internal Revenue Code. The Commissioner of the Internal Revenue Service (IRS) and representatives of public interest organizations which oversee the activities of charities will appear as witnesses at the hearing. The hearing is scheduled for Tuesday, June 15, 1993, beginning at 1:00 p.m., in room B-318 Rayburn House Office Building.

The Subcommittee will receive testimony providing an overview of tax law compliance issues involving public charities, and specifically focus on issues related to private inurement. To qualify for tax-exemption under section 501(c)(3), a public charity must be organized and operated so that no part of its net earnings inures to the benefit of any private individual, so-called private inurement. In addition, the Subcommittee will assess the difficulties IRS experiences in administering current tax rules applicable to public charities; identify the nature and extent of tax law noncompliance; assess the adequacy of current law sanctions; and evaluate whether the public and donors are receiving sufficient information from charitable organizations and IRS to properly monitor overall charitable activities, spending of charitable contributions, and compliance with current tax rules.

In announcing the hearing, Chairman Pickle stated: "Since becoming Oversight Chairman, I have conducted numerous hearings to look at issues involving tax-exempt organizations. I truly believe that these organizations provide an important service to our Nation. However, I also believe that tax-exemption is a privilege and that these organizations must maintain a high degree of accountability to the public. Unlike private corporations, tax-exempt organizations do not have stockholders or private investors closely monitoring their activities and expenditures. For this reason, we need to be certain that IRS maintains a strong enforcement presence to ensure compliance with the various laws applicable to tax-exempt organizations and that the public is given the information it needs to question and evaluate the actions of tax-exempt organizations.

"It is estimated that there are nearly one million public charities in existence today and an additional 30,000 are granted tax-exemption each year, making them the fastest growing sector of the U.S. economy. The public continues to raise important issues related to the level of compensation paid to executives of tax-exempt organizations, the business activities of organizations that evidence self-dealing, and the overall accountability of tax-exempt organizations to the public. I think that it is important for the Oversight Subcommittee to investigate what IRS and others are doing to monitor the activities of tax-exempt organizations, and determine what reforms are needed to improve compliance by tax-exempt organizations and IRS's administration of the law."

(MORE)

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Persons submitting written comments for the printed record of the hearing should submit six (6) copies by the close of business, Tuesday, July 6, 1993, to Janice Mays, Chief Counsel and Staff Director, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit 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 statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.
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. Statements must contain the name and capacity in which the witness will appear or, for written comments the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.
4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

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FOR IMMEDIATE RELEASE
FRIDAY, JULY 23, 1993

PRESS RELEASE #12
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1135 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-5522

THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN,
SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES,
ANNOUNCES THE SECOND PUBLIC HEARING TO REVIEW
THE FEDERAL TAX LAWS APPLICABLE TO PUBLIC CHARITIES

The Honorable J. J. Pickle (D., Texas), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will conduct a second hearing to review the administration of, and compliance with, the Federal tax laws applicable to public charities exempt from taxation under section 501(c)(3) of the Internal Revenue Code (IRC). Specifically, the Subcommittee will review the Internal Revenue Service's (IRS) and certain States' compliance activities involving public charities and examine the adequacy of current-law reporting on the Form 990 and related disclosure requirements. Representatives from IRS and various States have been invited to appear as witnesses. The hearing is scheduled for Monday, August 2, 1993, beginning at 1:30 p.m., in the main Committee hearing room, 1100 Longworth House Office Building.

IRS will present testimony on recent examinations of public charities, including audits conducted pursuant to the Coordinated Examination Program, situations involving inurement and private benefit, and the extent to which employees of public charities are reporting benefits on their individual tax returns. Also, IRS will address the Form 990 and possible changes to the Form to improve the ability of IRS and the public to monitor the operations of public charities. Further, State attorneys general and State charity officials will present testimony regarding efforts to improve the public accountability of charities, to eliminate abusive practices such as inurement and private benefit, and to enhance enforcement activities.

The Subcommittee will go into closed executive session at the beginning of the hearing to receive nondisclosable testimony from IRS field agents regarding issues involved in various cases under examination, instances evidencing inurement and private benefit, and other compliance matters. Following this session, IRS agents will provide public testimony, to the extent possible under IRC section 6103, regarding the above-referenced matters.

In announcing the hearing, Chairman Pickle stated: "This hearing is the second in a series of hearings by the Subcommittee to review the activities of public charities. While the vast majority of charities are dedicated solely to serving the public, it is clear that not all charities listen only to voices on high. There are over 400,000 public charities and not all of them are operated by people with halos. I believe it is imperative that the public and the IRS be able to identify the fallen angels, to judge them, and to act accordingly.

"I intend that these hearings will identify abuses of public trust and our laws by public charities and problems experienced by IRS in enforcement of our tax laws. Also, I intend that these hearings, and continued consultation with the Department of the Treasury and IRS, will lead to consideration of administrative and legislative reforms to address the abuses and problems. I expect that all of those interested in ensuring the continued good work and support of public charities, including tax-exempt organizations, donors, the public, and the Federal Government, will benefit from this ongoing review and the resulting reforms."

(MORE)

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Persons submitting written comments for the printed record of the hearing should submit six (6) copies by the close of business, Wednesday, August 25, 1993, to Janice Mays, Chief Counsel and Staff Director, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit 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.

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3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.
4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

#

Chairman PICKLE. I will ask the subcommittee to please come to order. Normally I say to our guests, please take a seat. I can't be that generous this afternoon. Those of you who are in the room may stay, but if you leave your place will be filled. We hope you can stay as long as you wish though.

I have an opening statement, then I am going to ask Congressman Houghton if he would like to make an opening statement.

Today, the Subcommittee on Oversight begins a series of hearings to review the activities of public charities exempt from Federal taxation under section 501(c)(3) of the Internal Revenue Code. Overall, there are more than 1.2 million organizations exempt from Federal income tax, not including an estimated 340,000 churches. These organizations annually generate \$500 billion in revenues. They have assets of approximately \$1 trillion and they employ about 7 million people. In recent years, tax-exempt organizations have been the fastest growing sector in the U.S. economy. In 1991, half of all tax-exempt organizations were public charities, 519,000. There are 30,000 new charities added to the list every year.

Due to the growth in the number, size and complex operations of public charities, serious questions exist about whether the IRS has been able to keep pace. IRS has fewer employees today monitoring nonprofits than in 1980. Funding for the Employee Plans/Exempt Organization Division continues to decline and the number of tax-exempt audits performed by IRS has dropped sharply.

This hearing, and those that will follow, are not an attempt to attack the character and good work of public charities in our cities and neighborhoods. The support, in both time and money, given by the public to charities is unmatched in the world. So, let me make it clear, compliant public charities will benefit from this review. We will work with the Treasury Department and IRS to more effectively identify the bad actors and make improvements where needed.

What concerns us today is the fact that some charitable organizations have abused the public trust and have allowed tax-deductible contributions to inure to the benefit of select privileged insiders. Our subcommittee looked at the tax returns for the 250 largest tax-exempt organizations and the salaries of the top 2,000 executives at these organizations. We found that 15 percent of these executives were paid more than \$200,000 per year and that there are 38 individuals making more than \$400,000.

In addition, review of these returns causes me to continue to ask questions. One, is it appropriate for a charitable organization to shift \$5 million tax-deductible dollars to its for-profit subsidiary?

Two, should a medical school vice president be allowed to borrow \$1 million interest-free to buy and renovate his house?

Three, should charitable contributions be used to pay a \$1 million salary to the chairman of an educational organization?

And four, should the administrator of a small pension plan be paid \$500,000 in salary? Also, press reports call into question whether tax-deductible donations should be used to provide charity officials with extravagant perks like luxury cars, servants, chauffeurs, country club memberships, and extremely lucrative severance packages.

The purpose of these hearings is to learn what IRS knows about these activities or possible abuses, and whether they should be allowed or stopped. We want to know if Federal law is adequate to ensure compliance by public charities and to appropriately punish wrongdoing. Most importantly, we want to know if the public is currently being provided access to the information necessary for them to make informed judgments about charitable giving.

I do not want to prejudice what needs to be done, but I do want to make some observations. I believe that the audits of tax-exempt organizations can be conducted more quickly. We have seen examinations that take 4 to 5 years and in the end, IRS gives the taxpayer a slap on the wrist and asks them to sign a closing agreement and to promise to be good next year. In cases of inurement or abuse, I believe IRS ought to be able to impose a penalty other than revocation, which no one wants, in order to combat the violations that are occurring.

With us today is Hon. Margaret Milner Richardson, the new IRS Commissioner. It is her first appearance before a House committee and we are delighted that she is with us today. We welcome her and her representatives to this hearing.

Following Commissioner Richardson will be representatives from the three nonprofit watchdog groups. These groups are constantly working to promote public accountability for charitable organizations. We look forward to their testimony as well.

Before we proceed, I will ask Congressman Houghton if he has a statement.

Mr. HOUGHTON. I am delighted to join you in this hearing. It is timely. There is a history of hearings such as this. The thrust is to find out whether the laws are being kept not only in fact but in spirit.

Thank you very much.

Chairman PICKLE. Do you have an opening statement?

Mr. HANCOCK. No. Let's get on with the hearing.

Chairman PICKLE. As is the custom of this subcommittee, we will put all witnesses under oath.

[Witnesses sworn.]

Chairman PICKLE. Let the record show that you said yes.

Now, Commissioner Richardson, we are pleased to have you here. Please make whatever statement you wish and then we will proceed with questions.

STATEMENT OF HON. MARGARET MILNER RICHARDSON, COMMISSIONER OF INTERNAL REVENUE, ACCOMPANIED BY JOHN E. BURKE, ASSISTANT COMMISSIONER, EMPLOYEE PLANS AND EXEMPT ORGANIZATIONS; JAMES J. McGOVERN, ASSOCIATE CHIEF COUNSEL, EMPLOYEE BENEFITS AND EXEMPT ORGANIZATIONS; AND HOWARD M. SCHOENFELD, SPECIAL ASSISTANT FOR EXEMPT ORGANIZATION MATTERS

Ms. RICHARDSON. Thank you, Mr. Chairman and distinguished members of the subcommittee. I am pleased to be here with you today to discuss the administration of tax laws applicable to public charities which are exempt from tax under section 501(c)(3) of the Internal Revenue Code.

This is an important area of tax administration and one which benefits greatly from oversight and public scrutiny.

With me are John Burke, Assistant Commissioner for Employee Plans and Exempt Organizations. I have Jim McGovern, the Associate Chief Counsel for Employee Benefits and Exempt Organizations; and Howard Schoenfeld, who is the Special Assistant for Exempt Organization Matters.

Chairman PICKLE. Can you hear this on the public address system now?

Ms. RICHARDSON. OK.

I particularly welcome not only the opportunity to appear before you for the first time as Commissioner of Internal Revenue, but also the opportunity this hearing presents to review the IRS compliance programs for public charities and to share with you our concerns about this important area of tax administration.

The hearing today, as you indicated, addresses the part of the universe of exempt organizations that are classified as public charities. These are the kinds of organizations that typically come to mind when one thinks of charities—churches, hospitals, universities and similar types of organizations which are financially dependent upon the public. Usually, but not always, such organizations are run by a board of directors that is fairly broad based and they exist in response to specific public needs.

In 1990, which is the last year for which we have complete information available, our records indicate that there were about 415,000 public charities, with revenues of \$406 billion, representing 7.4 percent of the gross domestic product. Public charities held assets of \$674 billion and they received \$80.9 billion in contributions, gifts and grants.

These statistics do not include assets of churches and church-related organizations which are not required to report information to the IRS.

We believe that public charities play a vital role in this Nation. They are effective instruments in addressing social and economic problems and they also help maintain our educational and cultural institutions and can often be credited with improving the quality of life for our citizens.

The Internal Revenue Code provides special treatment for public charities. They are exempt from income tax, and they are eligible to receive tax-deductible contributions. To be exempt from income tax under section 501(c)(3), an organization must be organized and operated exclusively for charitable purposes. The exemption from Federal taxation and eligibility for deductible contributions are based on the services or benefits these organizations provide to their communities.

Section 501(c)(3) of the Code and the regulations thereunder impose two key prohibitions on public charities exempt under the statute. First, inurement is prohibited. An organization qualifies for an exemption from tax only "if no part of its net earnings inures to the benefit of any private shareholder or individual."

Inurement occurs whenever a financial benefit represents a transfer of resources to a person with an inside relationship to a charity—for example, a founder, trustee, officer, or significant donor—solely because of the individual's relationship with the or-

ganization, without any regard to how the organization's exempt purpose would be accomplished.

The inurement prohibition applies throughout the existence of the public charity and even upon its liquidation.

The second prohibition, that against private benefit, is founded on the principle that a section 501(c)(3) organization must serve public, not private, interests. In contrast to inurement, the private benefit prohibition is not limited to insiders. Benefits that flow to anyone outside the group the charity is serving have to be looked at.

Some private benefit is permitted under the statute, as long as that private benefit is incidental to the public benefit involved. To make that determination requires balancing the private benefit conferred upon an individual by an activity against the public benefit achieved by that activity.

As I will discuss a little later, both inurements and the private benefit rules present difficulties for effective tax administration.

Chairman PICKLE. I am having trouble following you. Will you tell me what page you are on.

Ms. RICHARDSON. I am sorry, page 5.

As I will discuss later, both the inurement and the private benefit rules present difficulties for effective tax administration. More importantly, the only sanction for violation of these and other exempt organization standards is revocation of the exemption.

The basic message that we want to convey to you today is that having revocation as the only sanction makes enforcement of the charitable organization provisions difficult for the IRS.

I do want to note that I have not yet had the opportunity to study carefully the question of the enforcement of the charitable organization provisions or to consider specific recommendations for improvements in the enforcement provisions with my colleagues in the new administration at the Treasury Department.

What I would like to leave you with this afternoon is some sense of the problems we at the Service encounter on a day-to-day basis in trying to administer the rules that currently apply to the public charities.

Before I turn to a discussion of the Service's enforcement program for public charities, I think it may be helpful to provide a brief overview of the universe of exempt organizations. Any exempt organization that receives more than \$25,000 annually is required to file with the IRS a form 990, which is a return for organizations exempt from income tax, and to make that form 990 available for public inspection upon request.

Less than 40 percent of all exempt organizations meet this test. There are also about 60,000 churches and their exempt affiliates which are not required to file form 990. Currently there are approximately 1.1 million exempt organizations on our exempt organization master file.

Only 23 percent of the public charities that are required to file have assets in excess of \$1 million. Our examination resources are focused then on these organizations with the assets in excess of \$1 million.

Several years ago, we assessed the effectiveness of our traditional exempt organization audit efforts and we determined that

our traditional approach of using an exempt organization agent to examine a large exempt organization was not adequate to audit conglomerates and other systems that included taxable subsidiaries, joint ventures, and other complex arrangements or transactions. Consequently, we began using a new examination approach to strengthen our exempt organization enforcement program.

This new approach, which we refer to as the coordinated examination program or CEP, was designed and implemented to enable our field agents to audit effectively the increasingly complex activities of large exempt organizations such as hospital systems and universities.

CEP audits of larger and more complex exempt organizations are conducted by a team of exempt organization agents, plus specialist agents as they are needed. They work on assigned portions of a large exempt organization case under the direction of a case manager.

Specialist agents may include pension examiners, engineers, excise tax agents, international examiners, computer audit specialists, income tax agents and economists. Personnel from the exempt organization function in the National Office and the Office of Chief Counsel also participate in these audits.

Before we implemented this coordinated examination program, exempt organization audits were typically limited to reviewing the activities of tax-exempt organizations and verifying the accuracy of the information that was reported on the form 990 information return and any form 990-T which is the Exempt Organization Business Income Tax Return.

If warranted, the exempt organization agent would audit the employment tax returns of the organization and the returns of any related tax-exempt entities. We concluded that these audits were simply not adequately examining transactions that included related or affiliated taxable entities such as taxable subsidiaries, joint ventures, partnerships and related individuals.

Exempt organization action on possible noncompliance among those related parties was basically limited to referring a matter to our examination function. As a result, there are very few instances where an examination of a large diverse organization surfaced all of the issues that affected exempt status or even of tax liabilities.

In addition to our CEP exams, we have now established priorities which we review annually for using our resources to address the issues and activities that we believe have the greatest effect on society. The exempt organization function has moved to an enforcement program that examines the largest organizations and focuses on the issues that affect the greatest number of our citizens.

These issues include questionable or potentially abusive practices involving charitable fund raising, tax-exempt bond issues, unrelated business activity, media evangelists, and political activities by charitable organizations.

To obtain maximum results from our exempt organization enforcement activity, our audit resources are being applied to those organizations most in need of audit attention. The audits of those organizations are comprehensive and cover all relevant tax issues. They are being conducted by skilled, experienced and trained ex-

aminers and they are well supported and well managed, we believe.

We also believe that most public charities attempt to comply with the law. As we have concluded our examinations of large public charities, however, we have identified and continue to identify a number of common abuses. Forms of inurement, including excessive compensation, are among the types of abuses we most often find among large exempt organizations.

While compensation of officers and executives varies widely among hospitals, televangelists, or other public charities, such compensation, including fringe benefits, is often not accurately reported on the form 990. Frequently, payments that are reported fail to properly include benefits such as chauffeur-driven limousines, private yachts, maid service or deferred compensation that should be included.

The exempt organization examinations have also raised significant income tax issues for related persons including failure to report income on individual tax returns or not filing income tax returns at all. Because our CEP audit program has been under way a relatively short period of time, we do not yet have very precise data on the extent of noncompliance.

I can assure you, however, that we are taking steps to remedy that situation now.

The Internal Revenue Code and accompanying regulations provide that qualified charitable organizations cannot allow any part of their net earnings to inure to the benefit of private individuals. They cannot permit more than an "insubstantial part" of their activities to be conducted in furtherance of a nonexempt purpose.

They cannot have a "substantial part" of their activities devoted to lobbying and they cannot participate in electoral politics.

Because the language of the statute, and even the concepts underlying the statute are imprecise, the current rules present difficulties for effective tax administration. For example, there has been extensive controversy over how much noncharitable activity must occur in order to be substantial.

Under current law, the sanction for violation of any of the provisions is revocation of an organization's exemption. This sanction is often too severe because it penalizes innocent parties. Particularly where the wrongdoing is relatively minor, the IRS is faced with an uncomfortable choice—either to revoke an organization's exemption and cause untold havoc or to walk away and do nothing.

We have also encountered situations where officers and other fiduciaries have virtually looted a public charity. Revocation of an organization's exemption—which at first blush might seem appropriate—in those situations is also a severe step that could adversely affect innocent parties in the very community that charity seeks to serve. More importantly, revocation of such an organization's exemption does not adequately focus punishment on the abusers.

As a method of forcing disengagement from abusive transactions by exempt organization officials and to keep the organizations operating and performing needed services for their communities, the IRS has used closing agreements with increasing frequency over the past few years.

Closing agreements in this context are contracts negotiated at the conclusion of an audit between the Service and officials of exempt organizations which specify actions to be taken to maintain or restore exempt status. They also generally require the payment of a tax.

We believe it is useful to have sanctions that are targeted against the specific abuses that occur and against those individuals who are responsible for any misconduct. In some instances, closing agreements have helped us to accomplish this objective. Although they have been helpful in addressing our enforcement difficulties in some cases, they are not the ideal tool.

For example, since each closing agreement is the result of separate negotiations with a particular exempt organization, it is virtually impossible for us as tax administrators to ensure that similar organizations are treated consistently. To assure such consistency, we believe that it would be useful to provide us with sanctions that are short of revocation to address violations of the standards for tax exemption.

I might turn to the form 990 because you had raised questions about whether rules that govern the filing of the form are sufficient to enable the public to determine whether organizations are complying or have complied with the law.

Form 990 returns of certain charitable organizations were first made available for public inspection by the Revenue Act of 1950. That Act's legislative history indicates the purpose of making the information return publicly available was the assumption that publicity alone is a check against potential abuses.

Since 1969, returns of most exempt organizations have been subject to public inspection. More recently, the public disclosure rules relating to form 990 have been broadened and strengthened by specifying that these returns must be complete and correct and also must be available at the organization's principal place of business.

Perhaps an indication of the success of the form 990 as a disclosure vehicle can be measured by the fact that since 1981, it has been adopted by all 35 States that have reporting requirements for charitable organizations. As an aside, I might mention that the use of a form 990 as a uniform financial report for a charitable organization represents a real model for Federal and State cooperation.

We feel it has been very successful in that area.

Changes to the form 990 may be needed to enable the public to understand whether an organization is in compliance with the exempt organization provisions. In addition, we believe that disclosure of IRS enforcement actions, which are not now permitted to be made public, would also have a salutary effect on the universe of exempt organizations.

Other sanctions short of revocation may also be appropriate, and we would like to explore these options with you, Mr. Chairman, and with your subcommittee.

In conclusion, I would like to say that the administration of the laws affecting public charities presents difficult challenges for the IRS. The public deserves effective tax administration in this area as it does in every other area, but because charities are subsidized by the public through the provision for exempting them from tax and allowing charitable contribution deductions, the IRS should not

be forced to choose between ignoring abusive transactions or revoking a charity's tax-exempt status.

We believe the time is here to work with you and your subcommittee, Mr. Chairman, with the Treasury Department and the public charity community to develop a fair and even-handed enforcement scheme.

I have a copy of a letter sent to you, Mr. Pickle, by Leslie Samuels, the Assistant Secretary for Tax Policy. With your permission, I would like to read it.

Treasury indicated their interest in helping develop some sanctions.

Chairman PICKLE. You may read the letter from Mr. Samuels and it will be made a part of the record.

Ms. RICHARDSON. The letter is addressed to the Hon. J.J. Pickle [reading]:

DEPARTMENT OF THE TREASURY,
Washington, D.C., June 15, 1993.

Hon. J.J. PICKLE,
Chairman, Subcommittee on Oversight,
U.S. House of Representatives, Washington, D.C.

DEAR CHAIRMAN PICKLE: We appreciate the interest of the Subcommittee on Oversight in the administration of, and compliance with, the Federal tax laws applicable to public charities exempt from taxation under section 501(c)(3) of the Internal Revenue Code. We look forward to working with the subcommittee and its staff, as well as the Internal Revenue Service, in considering possible reforms to improve compliance by tax-exempt organizations and to assist the Service in its administration of the laws applicable to tax-exempt organizations in a manner that is fair and equitable to those organizations.

Sincerely,

LESLIE B. SAMUELS,
Assistant Secretary (Tax Policy).

Mr. Chairman, we appreciate your interest in this area. We will be pleased to answer your questions.

[The prepared statement and attachments follow:]

Statement of
MARGARET MILNER RICHARDSON
COMMISSIONER OF INTERNAL REVENUE

Before the
SUBCOMMITTEE ON OVERSIGHT
HOUSE COMMITTEE ON WAYS AND MEANS

June 15, 1993

INTRODUCTION

Mr. Chairman and Distinguished Members of the Subcommittee:

Good afternoon, I am pleased to be here with you today to discuss the administration of and compliance with the federal tax laws applicable to public charities exempt under section 501(c)(3) of the Internal Revenue Code. With me are John E. Burke, Assistant Commissioner (Employee Plans and Exempt Organizations), James J. McGovern, Associate Chief Counsel (Employee Benefits and Exempt Organizations), and Howard M. Schoenfeld, Special Assistant for Exempt Organization Matters.

I particularly welcome not only the opportunity to appear before you for the first time as Commissioner of Internal Revenue, but also the opportunity this hearing presents to review the Internal Revenue Service's compliance programs for public charities and to share with you our concerns about this important area of tax administration.

Today's hearing addresses that part of the universe of charitable organizations classified as public charities. These are the kinds of institutions that typically come to mind when one thinks of charities -- that is, churches, hospitals, universities, and other similar types of organizations which are financially dependent upon the public. Usually, though not always, such organizations are controlled by a board of directors that is fairly broad-based, and, in most cases, they exist in response to a specific public need.

PUBLIC CHARITIES AND THEIR RELATIVE IMPORTANCE

The largest and most well-known group of tax exempt organizations are the 415,000 public charities described in section 501(c)(3). These organizations are the largest providers of philanthropic goods and services. In 1990, the last tax year for which we have information available, our records indicate that public charities had revenues of \$406 billion representing 7.4% of the Gross Domestic Product. Their total assets were \$674 billion. The amount of deductions allowed for gifts, grants, contributions, and bequests was \$80 billion. These statistics do not include assets of churches and church-related organizations, which do not report information to the IRS.

Public charities play a vital role in this nation. They are effective instruments in addressing social and economic problems. They offer a pluralistic alternative to governmental activity and can be credited with improving our educational and cultural institutions as well as the quality of life for our citizenry. In return, society indirectly subsidizes these organizations by making them exempt from taxation and eligible to receive deductible contributions from donors.

THE LEGAL FRAMEWORK

Section 501(a) of the Code exempts from federal income tax organizations described in section 501(c)(3). Section 501(c)(3) lists certain types of organizations, including, for example, those "organized and operated exclusively for religious, charitable, scientific, . . . or educational purposes."

Section 501(c)(3) and applicable regulations impose two key prohibitions on organizations they exempt. The first concerns inurement. An organization qualifies for exemption under section 501(c)(3) only if "no part of [its] net earnings . . . inures to the benefit of any private shareholder or individual." The inurement prohibition applies throughout the existence of a section 501(c)(3) organization and upon liquidation.

The proscription against inurement generally applies to a distinct class of private interests -- typically persons who, because of their particular relationship with an organization, have an opportunity to control or influence its activities. Thus, regulations interpreting section 501(a) of the Code make clear that the words "private shareholder

or individual" in section 501(c)(3) refer to persons having a personal and private interest in the activities of the organization, as opposed to members of the general public or the organization's intended beneficiaries. Treas. Reg. § 1.501(a)-1(c). These individuals are often referred to informally as "insiders." The clearest examples of insiders are founders, trustees or directors, officers, managers, and significant donors. Inurement arises whenever a financial benefit represents a transfer of resources to an individual solely by virtue of the individual's relationship with the organization, without regard to accomplishing its exempt purposes.

The second prohibition covers private benefit and is founded on the principle that a section 501(c)(3) organization must serve public, and not private, interests. Unlike inurement, the private benefit prohibition is not limited to insiders; benefits flowing to anyone outside the intended charitable class must be considered. However, in contrast to the absolute ban on inurement, some private benefit is allowed, so long as it is qualitatively and quantitatively incidental to the public benefits involved. This requires balancing the private benefit conferred by an activity against the public benefit achieved by that activity.

The relationship between inurement and private benefit was clarified by the Tax Court in American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989). There, the court explained that, "while the prohibitions against private benefit and private inurement share common and overlapping elements, the two are distinct requirements which must independently be satisfied." The court stated that the presence of private inurement violates both prohibitions, but the absence of inurement does not mean the absence of private benefit. Inurement, then, may be viewed as a subset of private benefit.

As discussed below, the inurement and private benefit rules present difficulties for effective tax administration. Most importantly, however, the sole sanction for violation of these and other exempt organization standards is revocation of the exemption. This limitation makes enforcement of the charitable organization provisions difficult. While this is the basic message I want to convey today, I note that I have not yet had the opportunity to carefully study this issue or to consider specific recommendations for improvement with my colleagues in the new Administration at the Treasury Department. What I would like to convey to you this afternoon is some sense of the problems the Service encounters on a day-to-day basis in trying to administer the rules as they apply to public charities.

CURRENT IRS ENFORCEMENT ACTIVITIES

I would like to address some elements of our exempt organizations compliance program. While there may be opportunities to improve compliance, the Service does not believe merely increasing the number of audits is the answer.

Taxpayer education and assistance have been important components of our compliance strategy. Moreover, in an era of declining resources, we recognize that we have to work more effectively and efficiently.

In recent years, we have faced difficult problems in administering the exempt organization laws. In addressing these problems, we found our traditional approach in sending an exempt organization specialist to examine a large exempt organization was not adequate to audit multi-corporate organizations that included taxable subsidiaries, joint ventures, and other complex arrangements or transactions. Consequently, we began using a new examination approach to strengthen our exempt organization enforcement program.

This new approach, the coordinated examination program ("CEP"), has been designed and implemented to allow our field agents to address intelligently and effectively the ever-increasing complexity of large exempt organizations such as hospitals and universities.

Before we implemented the CEP, exempt organization examinations usually were limited to reviewing the activities of tax exempt organizations and verifying the accuracy of the information reported on the Form 990, "Return of Organization Exempt From Income Tax," and any Form 990-T, "Exempt Organization Business Income Tax Return," filed by the organization. If warranted, the exempt organization examiner would audit the employment tax returns of the organization and the return of any related tax exempt entities. We concluded that these types of audits did not adequately address

transactions that included related or affiliated taxable entities, such as taxable subsidiaries, joint ventures, partnerships, and related individuals. Exempt organization specialists discovering possible noncompliance among related parties were limited to referring the matter to the Examination function, which had to balance its own competing priorities. As a result, there were few instances where an examination of a large organization even identified the totality of issues affecting exempt status or tax liabilities.

In response to concerns about the adequacy of our audit program, we initiated the CEP for exempt organizations. These audits are conducted by a team of exempt organization agents, plus specialist agents as needed, who work on assigned portions of a large exempt organization case under the direction of a case manager. Specialist agents may include pension examiners, engineers, excise tax agents, international examiners, computer audit specialists, income tax agents, and economists. In many instances, personnel from the exempt organization function in the National Office and the Office of Chief Counsel have assisted in these audits. Additionally, we established priorities for the use of limited Service resources to address the issues and activities that we believe have the greatest effect on our society. These include questionable or potentially abusive issues involving charitable fund-raising, tax exempt bond issuances, unrelated business activity, media evangelists, and political activities by charitable organizations. We have used the annual workplan to improve our advance planning so that each year's program proceeds in a more orderly fashion.

Our workplan conforms with the IRS Strategic Objectives, and it reflects the allocation of our resources consistent with these priorities. For example, we now schedule our Continuing Professional Education ("CPE") program and our Coordinated Examination Program ("CEP") training at the beginning of the fiscal year so that our exempt organization personnel are fully informed about technical positions on the issues they will be facing in that fiscal year. The exempt organization function has moved from an enforcement program based on coverage or presence to one that is issue-focused and often examines the largest organizations, along with those that touch the greatest number of our citizens.

To obtain the best results from our enforcement activity, we are assuring:

- our audit resources are being applied to those organizations most in need of audit attention;
- the audits of those organizations are comprehensive and cover all relevant tax issues;
- the audits are conducted by skilled, experienced, and trained examiners; and
- the audits are well-supported and well-managed.

For example, media evangelists, hospitals, and universities continue to be special emphasis areas in our examinations. The Service is currently examining 21 media evangelist cases, 21 hospital cases, and 10 university cases, as well as related entities and individuals. As discussed below, some of these cases raise questions as to whether the charity is serving a private purpose more than incidentally.

NONCOMPLIANCE AMONG PUBLIC CHARITIES

We believe that most public charities attempt to comply with the law most of the time. In recent examinations of large public charities, however, we are finding patterns of abuse that cause us concern. Although we lack precise data on the extent of noncompliance, we have found a number of cases of inurement and significant private benefit. In particular, we are concerned about potentially excessive compensation. These patterns of noncompliance illustrate the difficulty of administering the exempt organization laws effectively and thereby maintaining public confidence in the Service's ability to deal with abusive cases in this area. A discussion of the difficult legal issues we grapple with in examinations and the types of abuse we have found follows.

Inurement

Because the concept of private inurement is broad and lacks precise definition, the Service faces some difficulties in administering this area of the law. When a charity makes an expenditure or enters into an arrangement that appears to benefit a private interest, the first inquiry we must make is whether the person benefitted is an insider so that inurement is at issue, or a non-insider so that only the private benefit issue is raised. Under the inurement analysis, we must ask questions such as "Did the expenditure further an exempt purpose, and, if so, how? Was the arrangement negotiated at arm's-length? Was the payment at fair market value or did it represent reasonable compensation for goods and services?" These are difficult questions. Like most exempt organization questions, they turn on subtle factual distinctions. For example, many issues depend on a finding of fair market value, a determination on which we typically must rely upon taxpayer representations, independent appraisals, and IRS specialists.

The standards we use in determining whether a particular arrangement results in private inurement are designed to ensure that a charity's assets are protected and its exempt purposes fulfilled. There are few specific standards applicable only to exempt organizations, but where appropriate, we look to standards and precedents developed under section 162, governing deductions for ordinary and necessary business expenses. Resolution of inurement issues necessarily involves a close look at all the surrounding facts and circumstances. This explains why the Service does not rule in advance on questions such as whether compensation is reasonable or an amount represents fair market value.

Examples of abusive transactions we have found that benefitted insiders of public charities include:

- An organization retroactively lost exemption where it engaged in numerous transactions with an insider, including purchase of a 42-foot boat for the personal use of the insider. The insider also benefitted from several real estate transactions, including donations and sales of real property to the organization which were never reflected on its books. Also, a for-profit corporation controlled by the insider leased from the charity on a rent-free basis land, buildings, and personal property.
- In 1991, the IRS retroactively revoked a hospital's exemption because, a few years earlier, its 12-member board had established a new for-profit corporation and sold the hospital to the new corporation (i.e., themselves) at less than fair market value. When they later resold the hospital, each director received more than \$2.3 million as their share of the proceeds.
- The Service revoked the exemption of a church that began operating commercial businesses and paying substantial private expenses of its founders, including expenses for jewelry and clothing in excess of \$30,000 per year. The organization also purchased five luxury cars for the founders' personal use. None of these benefits were reported as personal income to the founders.
- In 1992, we revoked three private ruling letters approving transactions in which hospitals sold the expected net revenue streams from their outpatient surgery departments to joint ventures owned by physicians who refer patients there. They were revoked because, upon reconsideration, the Service deemed the sale of the revenue streams to staff physicians to constitute inurement per se. In response to an Announcement offering possible closing agreements with respect to similar transactions, 18 additional hospitals approached us.

Private Benefit

No matter how difficult inurement questions can be, private benefit questions pose even greater challenges. They frequently require us to balance facts indicating public benefit against those indicating private benefit and to distinguish carefully intended from unintended benefits. In determining whether an organization is serving private interests more than incidentally, we look to the purposes underlying a given activity as well as its results.

In General Counsel Memorandum 37789 (Dec. 18, 1978), the Service explained the standard used in balancing private benefit against public benefit. Any private benefit arising from a particular activity must be "incidental" in both a qualitative and quantitative sense to the overall public benefit achieved by the activity if the organization is to remain exempt. To be "qualitatively incidental," a private benefit must occur as a necessary concomitant of the activity that benefits the public at large; in other words, the benefit to the public cannot be achieved without necessarily benefiting private individuals. Such benefits might also be characterized as indirect or unintentional. To be "quantitatively incidental," a benefit must be insubstantial when viewed in relation to the public benefit conferred by the activity. Even though exemption of the entire organization may be at stake, the private benefit conferred by an activity or arrangement is balanced only against the public benefit conferred by that activity or arrangement, not the overall good accomplished by the organization.

We also have found instances of public charities benefitting private interests more than incidentally:

- The IRS revoked an educational organization's exemption in 1992 where we found that it had a substantial purpose of furthering the interests of a for-profit consulting firm. Substantially all its expenses were paid to the for-profit firm or individuals with close connections to it with minimal amounts of educational materials being produced.
- The Service also revoked exemption of a charity where it served the commercial purposes and private interests of a professional fund-raiser where the fund-raiser distributed only 3% of the amount collected to the exempt organization.

Unreasonable Compensation

Unreasonable compensation in the exempt organizations area is best viewed as a subset of private inurement. However, we note that excessive compensation issues are not unique to exempt organizations. They arise throughout the business, professional, and nonprofit sectors of the economy. It is well-established that payment by a charity of reasonable salaries to managers, officers, or other employees does not constitute inurement of net earnings to the recipient and does not defeat exemption of an otherwise exempt organization. On the other hand, excessive and therefore unreasonable compensation can result in a finding of prohibited inurement. Mabee Petroleum Corp. v. United States, 203 F.2d 872 (5th Cir. 1953); Harding Hosp., Inc. v. United States, 505 F.2d 1068 (6th Cir. 1974); Birmingham Business College, Inc. v. Comm'r, 276 F.2d 476 (5th Cir. 1960).

As a result of our improved examination efforts, we are beginning to encounter cases involving potentially unreasonable compensation. Our examinations also are beginning to surface significant income tax issues with respect to related individuals, including organizations failing to report compensation on Forms W-2 or 1099; individuals failing to report income; and a few cases of individuals failing to file income tax returns at all. In some instances, we have discovered disguised compensation and amounts that are not completely or accurately disclosed on the Form 990.

Evaluating whether compensation is excessive is a difficult question of fact. We recognize that many of today's charities, like their counterparts in the business sector, are complex institutions requiring skilled managers. Many of the standards used in compensation cases are those developed with respect to the deductibility under section 162 of compensation in taxable businesses. Reasonable compensation is "only such amount as would ordinarily be paid for like services by like enterprises under like circumstances." Treas. Reg. § 1.162-7(b)(3).

SUFFICIENCY OF CURRENT SANCTIONS FOR NONCOMPLIANCE

The lack of a sanction short of revocation of exemption in cases in which an organization violates the inurement standard or one of the other standards for exemption causes the Service significant enforcement difficulties. Revocation of an exemption is a severe sanction that may be greatly disproportional to the violation in issue. For example, assume that an examination of a large university reveals that the university is providing its president with inappropriate benefits. The university may be paying the president a salary that appears excessive in comparison to that paid to presidents of comparable universities. Alternatively, the university may have provided

the president with a substantial interest-free loan. It may have paid for costly and luxurious amenities in the president's official residence. Each of these facts would raise serious inurement questions. Revoking the university's exemption, however, may be an inappropriate penalty. Revocation could adversely affect the entire university community -- employees, students, and area residents. Moreover, even if the organization's exemption were revoked, the president would be able to retain the benefits inappropriately received from the university. In short, the Service may be faced with the difficult choice of revoking an organization's exemption or taking no enforcement action as long as the compensation in question has been reported accurately on the individual's income tax return.

We have attempted to use closing agreements as a means of addressing the difficulties I have just described. By threatening an organization with revocation of its exemption, we may be able to secure the organization's agreement to take various steps to remedy questionable transactions and not engage in similar transactions in the future. A closing agreement with the hypothetical university, for example, could require the president to compensate the university for arguably inappropriate benefits. The agreement could specify the president's salary during a prescribed term. It could require termination of any interest-free loans or the removal of excessive amenities from the president's official residence. The agreement could also require the university to publicize any questionable transactions, thereby allowing interested members of the public to be alert to any similar transactions in the future.

Although closing agreements have been helpful in addressing our enforcement difficulties, they are not an ideal tool. In particular, because each agreement results from separate negotiations with a particular organization, it is difficult to ensure that similar organizations are treated consistently.

The enforcement difficulties described above call into question the sufficiency of the current sanctions for noncompliance with the standards for tax exemption. These difficulties suggest that it would be useful to provide the Service with a sanction short of revocation to address violations of these standards.

Although sanctions short of revocation for violations of the standards for tax exemption would be useful enforcement tools, any such sanctions raise interpretive questions regarding the standards themselves. As noted above, the concept of inurement is broad and imprecise. The private benefit standard requires balancing of public and private benefits. Over time, the precise contours of the standards may be clarified by cases involving the application of any intermediate sanctions. Initially, however, exempt organizations may have inadequate guidance concerning when a particular activity or transaction may result in the imposition of sanctions. Therefore, in considering any new sanctions, consideration should also be given to the possibility of clarifying the standards for tax exemption.

FORM 990 AS A COMPLIANCE TOOL

You asked whether current law and the Form 990 are sufficient to enable the public to determine whether organizations are complying, or have complied, with the law. By and large, we believe the annual information return achieves this purpose. Public charities that file Forms 990 are required to make those forms available for public inspection. This requirement that public charities operate in the "sunshine" advances the Service's overall goal of voluntary compliance. However, there may be steps that could improve disclosure both through the Form 990 and otherwise.

Form 990 returns of certain charitable organizations were first made available for public inspection by the Revenue Act of 1950. Legislative history tells us the purpose in making that information return publicly available was based on checking potential abuses. That assumption was effectively ratified in 1969 when the returns of all organizations were similarly made subject to public inspection.

The success of Form 990 is evidenced by the fact that 35 state attorneys general have adopted the form for use in their regulation of public charities. The use of Form 990 as a uniform financial report for charitable organizations represents a model for federal and state cooperation. Federal and state representatives meet at least annually with members of the interested public to look for ways to improve and streamline reporting on that return, always bearing in mind that it is used to show how the

reporting organization is satisfying its tax exemption requirements. Suggestions on content are always welcome.

Competing considerations go into the design of this return. On the one hand, regulators have a desire for more information to be reported. On the other, the important goals of the Federal Paperwork Reduction Act to minimize an organization's reporting burden must always be taken into account. Balancing these competing considerations is a difficult task. We believe that the current law regarding reporting and disclosure by public charities is basically satisfactory. Nevertheless, there have been isolated instances of incomplete reporting, especially of executive salaries and benefits, and of failure to produce the forms upon request. Our examinations routinely turn up circumstances where compensation is not properly reflected on Forms 990 or not properly characterized as compensation by the organization. These circumstances evidence the variety of available means of disguising payments of salaries and fringe benefits.

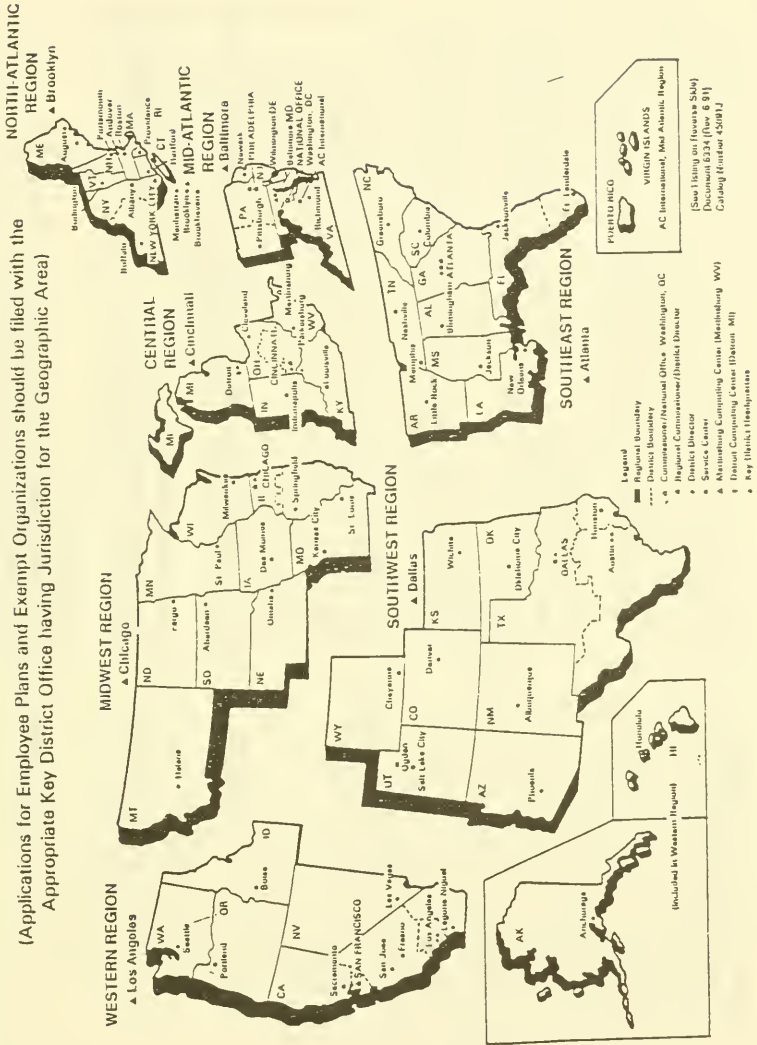
Changes to Form 990 to enable the public to have greater knowledge of a public charity's operations may be appropriate. The public's overall understanding of an organization's activities is important. There may be other alternative vehicles which are more appropriate, and we look forward to exploring those options with you, Mr. Chairman, and with your Subcommittee.

CONCLUSION

As seen from the foregoing, the administration of the laws affecting public charities presents difficult challenges for the Internal Revenue Service. The standards governing tax exemption are imprecise. Moreover, the sole sanction for violation of these standards is revocation of exemption. Effective administration of these laws is particularly important, however, because of the valuable subsidies granted to public charities in the form of tax exemptions and the eligibility to receive tax-deductible contributions.

We do not intend for our testimony today to present an unrepresentative view of public charities. Our regulatory role requires us to focus on the relatively few cases involving questionable practices, however, we recognize that these cases are not representative of the philanthropic community as a whole. Private philanthropy is a vital part of our national welfare and an effective instrument in directing national attention to varied social needs. A classic example occurred last year when many of our citizens were confronted by Hurricane Andrew -- the most destructive natural disaster in our nation's history. Swiftly and selflessly, America's churches and charities joined with the civilian and military arms of government to assist our citizens in a time of great need. Because public charities play a valuable role in our society, any new sanctions applicable to public charities should be carefully tailored so that they do not interfere with the charities' legitimate philanthropic activities. We anticipate a constructive dialogue with the charitable sector as the issues framed by this hearing are addressed.

Thank you for your interest in this area. We look forward to working with the Subcommittee and its staff on these issues. My colleagues and I would be happy to answer any questions.



**Employee Plans and Exempt
Organizations Key Districts**

IRS Districts Covered

Cincinnati	<p>Central Region</p> <p>Cincinnati, Cleveland, Louisville, Indianapolis, Parkersburg, Detroit</p>
Baltimore	<p>Mid-Atlantic Region</p> <p>Baltimore (which includes the District of Columbia and Puerto Rico), Pittsburgh, Richmond, AC International, Newark, Philadelphia, Wilmington</p>
Chicago	<p>Midwest Region</p> <p>Chicago, St. Paul, St. Louis, Fargo, Aberdeen, Milwaukee, Springfield, Des Moines, Omaha, Helena</p>
Brooklyn	<p>North-Atlantic Region</p> <p>Boston, Augusta, Burlington, Providence, Hartford, Portsmouth, Manhattan, Brooklyn, Albany, Buffalo</p>
Atlanta	<p>Southeast Region</p> <p>Atlanta, Jacksonville, Ft. Lauderdale, Greensboro, Columbia, Nashville, Jackson, Birmingham, Little Rock, New Orleans</p>
Dallas	<p>Southwest Region</p> <p>Dallas, Austin, Houston, Albuquerque, Denver, Cheyenne, Salt Lake City, Wichita, Phoenix, Oklahoma City</p>
Los Angeles	<p>Western Region</p> <p>Los Angeles, Honolulu, Laguna Niguel, San Francisco, Sacramento, San Jose, Las Vegas, Seattle, Portland, Anchorage, Boise</p>

**CATEGORIES OF
SECTION 501(c)(3) PUBLIC CHARITIES
AS OF MAY 31, 1993**

TYPE OF ORGANIZATION	INTERNAL REVENUE CODE	NUMBER
Church	170 (b)(1)(A)(i)	62,340
School	170 (b)(1)(A)(ii)	15,312
Hospitals, clinics, etc.	170 (b)(1)(A)(iii)	5793
State or local government college endowment fund	170 (b)(1)(A)(iv)	876
State or local government unit	170 (b)(1)(A)(v)	240
Organization supported by governmental unit or general public	170 (b)(1)(A)(vi)	199,473
Public charity supported by public receipts	509 (a)(2)	169,071
Public charity supporting organization	509 (a)(3)	20,487
Testing for public safety	509 (a)(4)	58

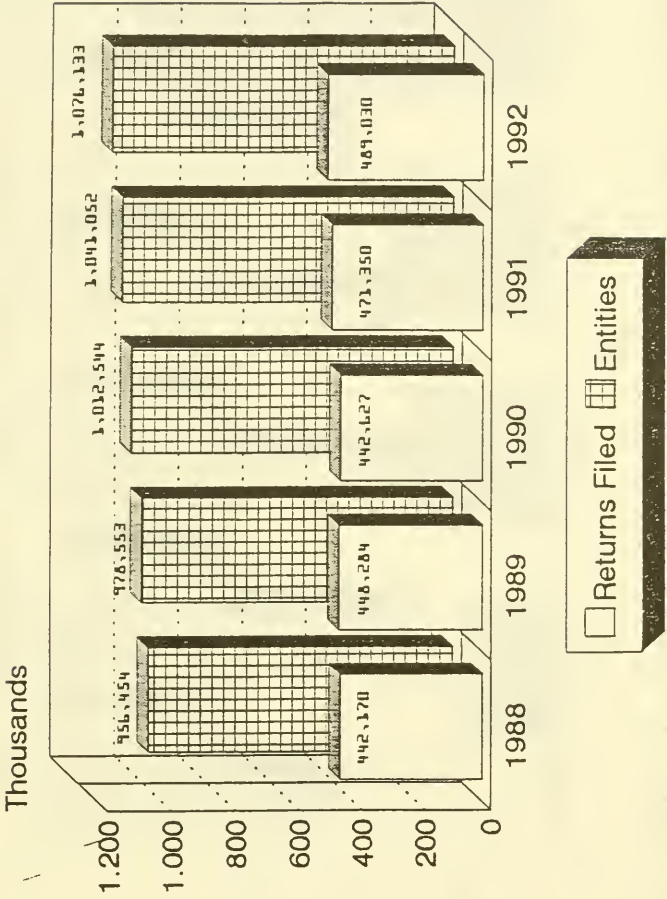
TOTAL: 473,650

EO ENTITIES BY ILC SUBSECTION

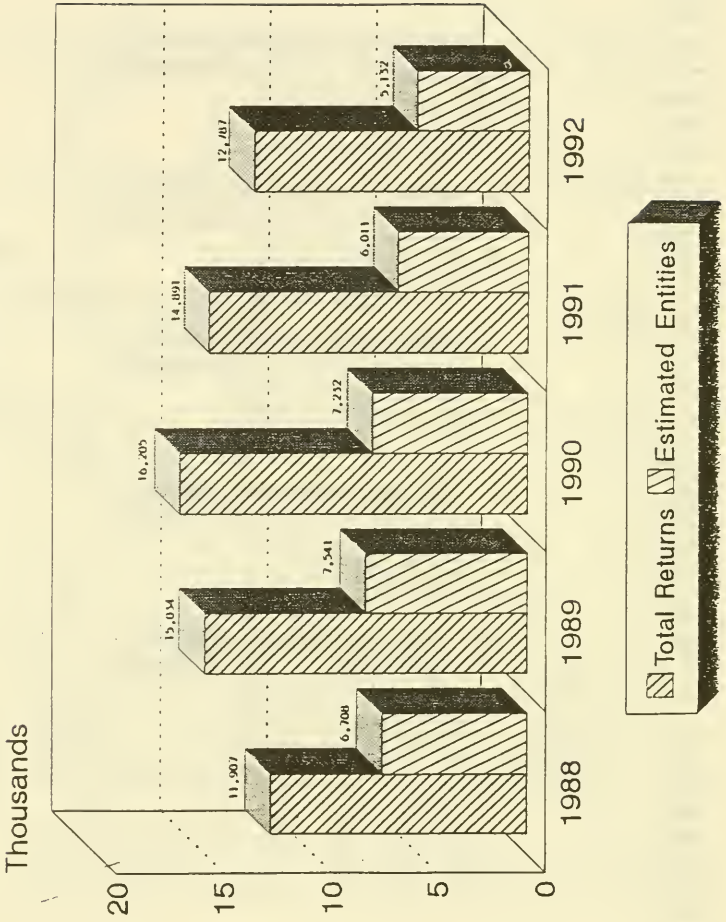
ILC SUBSECTION

	1968	1969	1990	1991	1992
501(c)(1) Government Instrumentality	27	28	20	5	3
501(c)(2) Title Holding Corp.	5,698	5,728	5,900	6,008	6,107
501(c)(3) Charitable Organization	422,689	436,990	461,775	487,218	517,857
501(c)(4) Civic League	131,132	131,999	133,708	133,069	132,656
501(c)(5) Agricultural Organization	68,371	67,802	68,427	67,855	66,953
501(c)(6) Board of Trade	58,238	59,792	61,447	63,678	65,773
501(c)(7) Pleasure, Recreational, Social	56,355	56,482	57,336	58,228	58,476
501(c)(8) Fraternal Beneficiary Society	89,171	89,792	90,486	88,109	88,952
501(c)(9) Voluntary Employee Beneficiary	12,185	12,791	13,688	13,931	14,345
501(c)(10) Domestic Fraternal Society	17,598	17,701	17,598	17,636	20,432
501(c)(11) Teachers Retirement Fund Assoc.	8	8	8	8	9
501(c)(12) Benevolent Life Insurance	5,497	5,541	5,607	5,704	5,792
501(c)(13) Burial Association	7,982	8,136	8,298	8,482	8,684
501(c)(14) Credit Union	6,368	6,011	6,068	5,515	5,454
501(c)(15) Mutual Insurance Assoc.	1,046	1,059	1,081	1,097	1,102
501(c)(16) Crop Financing Corp.	15	16	18	17	20
501(c)(17) Supplemental Unemployment Compensation Trust	665	626	629	600	583
501(c)(18) Employee Funded Pension Trust	8	8	8	8	8
501(c)(19) War Veterans Organization	25,835	26,094	27,087	27,477	28,487
501(c)(20) Legal Service	197	191	189	199	206
501(c)(21) Black Lung Trust	22	22	23	23	23
501(c)(22) Multiemployer Pension Plan	0	0	0	0	0
501(c)(23) Pre-1880 Veterans Assoc.	0	2	2	2	2
501(c)(24) ERISA Section 4049 Trust	30	0	0	1	1
501(c)(25) Title Holding Corp. or Trust	91	50	127	191	313
501(d) Apostolic Organization	75	92	92	91	90
501(e) Coop. Hospital Service Org.	75	72	69	62	56
501(f) Coop. Service Organization of Operation Education Org.	1	1	1	1	1
501(k) Charitable Child Care	2	9	9	10	1
521 Farmers' Cooperative	2,166	2,096	2,187	1,929	1,788
4947(a)(2) Split Interest Trust	34,367	36,524	39,357	42,319	45,232
4947(a)(1) Charitable Trust	4,979	5,149	5,363	5,675	5,902
1301(a)(2) Taxable Farmers' Cooperative	3,282	3,269	3,240	3,177	3,112
Other	2,354	2,472	2,662	2,727	2,673
TOTAL	956,454	979,553	1,012,544	1,041,052	1,076,133

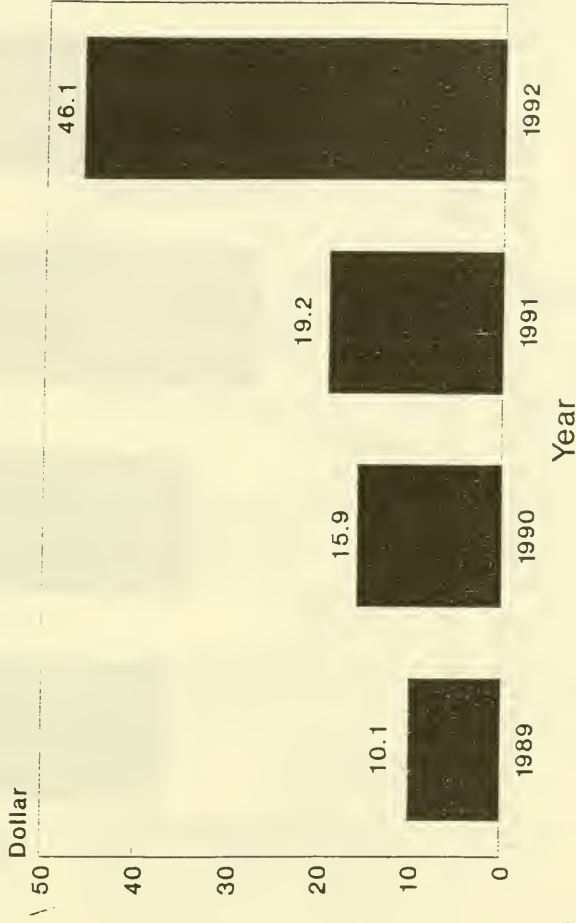
EXEMPT ORGANIZATION ENTITIES



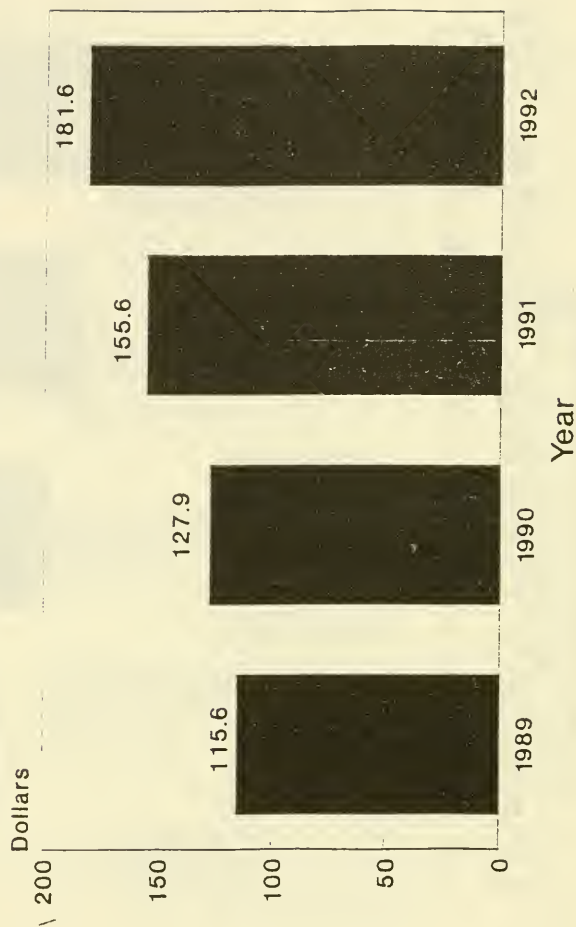
TOTAL EXEMPT ORGANIZATIONS RETURNS AND ENTITIES EXAMINED



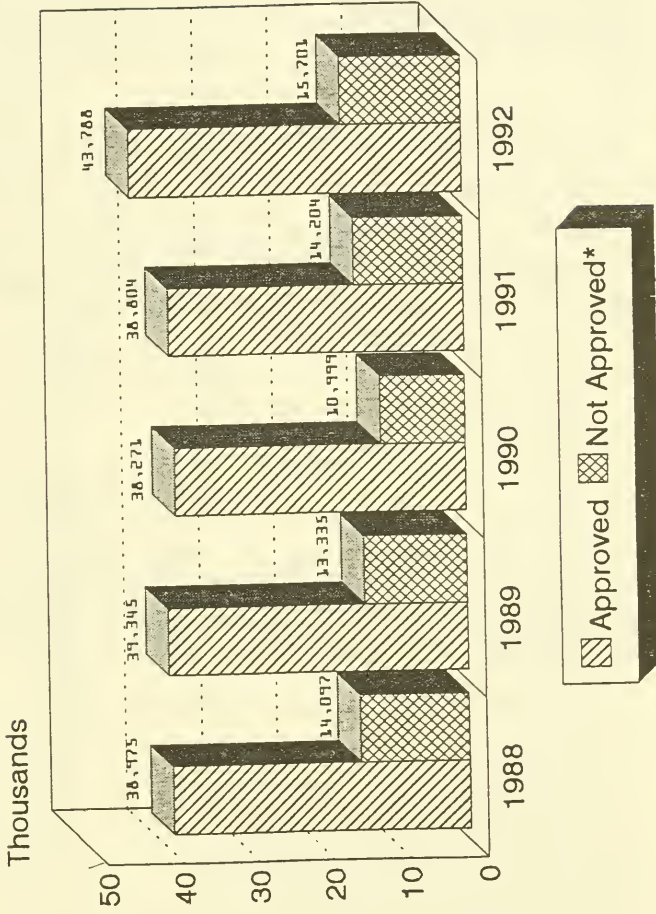
Unrelated Business Income Tax Examination Assessments (in Millions)



Unrelated Business Income Tax Collections (Receipts in \$ Millions)



EXEMPT ORGANIZATIONS DETERMINATIONS



*Denial, Failure to Establish, Withdrawals, Refusal to Rule

Form **990****Return of Organization Exempt From Income Tax**

Under section 501(c) of the Internal Revenue Code (except black lung benefit trust or private foundation) or section 4947(a)(1) charitable trust

OMB No. 1545-0047

1992This Form is
Open to Public
InspectionDepartment of the Treasury
Internal Revenue Service

Note: The organization may have to use a copy of this return to satisfy state reporting requirements.

A For the calendar year 1992, or fiscal year beginning , 1992, and ending , 19		C Employer identification number
Please use IRS label or print or type. See Specific Instructions.	B Name of organization	D State registration number
	Number and street (or P.O. box if mail is not delivered to street address) Room/suite	
	City, town, or post office, state, and ZIP code	
		E If address changed, check box <input type="checkbox"/> <input type="checkbox"/>

F Check type of organization—Exempt under section <input type="checkbox"/> 501(c)() (insert number), OR <input type="checkbox"/> section 4947(a)(1) charitable trust	G If exemption application pending, check box <input type="checkbox"/> <input type="checkbox"/>
H(a) Is this a group return filed for affiliates? <input type="checkbox"/> Yes <input type="checkbox"/> No (b) If "Yes," enter the number of affiliates for which this return is filed: <input type="text"/>	I If either box in H is checked "Yes," enter four-digit group exemption number (GEN) <input type="text"/>
(c) Is this a separate return filed by an organization covered by a group ruling? <input type="checkbox"/> Yes <input type="checkbox"/> No	J Accounting method: <input type="checkbox"/> Cash <input type="checkbox"/> Accrual <input type="checkbox"/> Other (specify) <input type="text"/>

K Check here ☐ if the organization's gross receipts are normally not more than \$25,000. The organization need not file a return with the IRS, but if it received a Form 990 Package in the mail, it should file a return without financial data. Some states require a complete return.

Note: Form 990EZ may be used by organizations with gross receipts less than \$100,000 and total assets less than \$250,000 at end of year.

Part I Statement of Revenue, Expenses, and Changes in Net Assets or Fund Balances

Revenue	1 Contributions, gifts, grants, and similar amounts received:				
	a Direct public support	1a			
	b Indirect public support	1b			
	c Government grants	1c			
	d Total (add lines 1a through 1c) (attach schedule—see instructions)	1d			
	2 Program service revenue (from Part VII, line 93)	2			
	3 Membership dues and assessments (see instructions)	3			
	4 Interest on savings and temporary cash investments	4			
	5 Dividends and interest from securities	5			
	6a Gross rents	6a			
	b Less: rental expenses	6b			
	c Net rental income or (loss)	6c			
7 Other investment income (describe <input type="text"/>)	7				
Expenses	8a Gross amount from sale of assets other than inventory	(A) Securities	(B) Other		
	b Less: cost or other basis and sales expenses	8a	8b		
	c Gain or (loss) (attach schedule)	8c			
	d Net gain or (loss) (combine line 8c, columns (A) and (B))	8d			
	9 Special fundraising events and activities (attach schedule—see instructions):				
	a Gross revenue (not including \$ of contributions reported on line 1a)	9a			
	b Less: direct expenses	9b			
	c Net income	9c			
	10a Gross sales less returns and allowances	10a			
	b Less: cost of goods sold	10b			
Net Assets	c Gross profit or (loss) (attach schedule)	10c			
	11 Other revenue (from Part VII, line 103)	11			
	12 Total revenue (add lines 1d, 2, 3, 4, 5, 6c, 7, 8d, 9c, 10c, and 11)	12			
	13 Program services (from line 44, column (B)) (see instructions)	13			
	14 Management and general (from line 44, column (C)) (see instructions)	14			
	15 Fundraising (from line 44, column (D)) (see instructions)	15			
	16 Payments to affiliates (attach schedule—see instructions)	16			
	17 Total expenses (add lines 16 and 44, column (A))	17			
18 Excess or (deficit) for the year (subtract line 17 from line 12)	18				
19 Net assets or fund balances at beginning of year (from line 74, column (A))	19				
20 Other changes in net assets or fund balances (attach explanation)	20				
21 Net assets or fund balances at end of year (combine lines 18, 19, and 20)	21				

For Paperwork Reduction Act Notice, see page 1 of the separate instructions.

Cat No. 11282Y

Form 990 (1992)

Form 990 (1992)

Part II Statement of Functional Expenses

All organizations must complete column (A). Columns (B), (C), and (D) are required for section 501(c)(3) and (4) organizations and 4947(a)(1) charitable trusts but optional for others. (See instructions.)

Do not include amounts reported on line 6b, 8b, 9b, 10b, or 16 of Part I.		(A) Total	(B) Program services	(C) Management and general	(D) Fundraising
22	Grants and allocations (attach schedule)	22			
23	Specific assistance to individuals (attach schedule)	23			
24	Benefits paid to or for members (attach schedule)	24			
25	Compensation of officers, directors, etc.	25			
26	Other salaries and wages	26			
27	Pension plan contributions	27			
28	Other employee benefits	28			
29	Payroll taxes	29			
30	Professional fundraising fees	30			
31	Accounting fees	31			
32	Legal fees	32			
33	Supplies	33			
34	Telephone	34			
35	Postage and shipping	35			
36	Occupancy	36			
37	Equipment rental and maintenance	37			
38	Printing and publications	38			
39	Travel	39			
40	Conferences, conventions, and meetings	40			
41	Interest	41			
42	Depreciation, depletion, etc. (attach schedule)	42			
43	Other expenses (itemize): a	43a			
b		43b			
c		43c			
d		43d			
e		43e			
f		43f			
44	Total functional expenses (add lines 22 through 43). Organizations completing columns (B)-(D), carry these totals to lines 13-15.	44			

Reporting of Joint Costs.—Did you report in column (B) (Program services) any joint costs from a combined educational campaign and fundraising solicitation? ☐ Yes ☐ No

If "Yes," enter (i) the aggregate amount of these joint costs \$ _____; (ii) the amount allocated to program services \$ _____; (iii) the amount allocated to management and general \$ _____; and (iv) the amount allocated to fundraising \$ _____.

Part III Statement of Program Service Accomplishments (See instructions.)

Describe what was achieved in carrying out the organization's exempt purposes. Fully describe the services provided; the number of persons benefited; or other relevant information for each program title. Section 501(c)(3) and (4) organizations and section 4947(a)(1) charitable trusts must also enter the amount of grants and allocations to others.

	Expenses (Required for 501(c)(3) and (4) organizations and 4947(a)(1) trusts; optional for others.)
a	
	(Grants and allocations \$ _____)
b	
	(Grants and allocations \$ _____)
c	
	(Grants and allocations \$ _____)
d	
	(Grants and allocations \$ _____)
e	Other program services (attach schedule) (Grants and allocations \$ _____)
f	Total (add lines a through e) (should equal line 44, column (B))



Part IV Balance Sheets

Note: Where required, attached schedules and amounts within the description column should be for end-of-year amounts only.		(A) Beginning of year	(B) End of year
Assets			
45	Cash—non-interest-bearing		45
46	Savings and temporary cash investments		46
47a	Accounts receivable 47a		
b	Less: allowance for doubtful accounts 47b		47c
48a	Pledges receivable 48a		
b	Less: allowance for doubtful accounts 48b		48c
49	Grants receivable		49
50	Receivables due from officers, directors, trustees, and key employees (attach schedule)		50
51a	Other notes and loans receivable (attach schedule) 51a		
b	Less: allowance for doubtful accounts 51b		51c
52	Inventories for sale or use		52
53	Prepaid expenses and deferred charges		53
54	Investments—securities (attach schedule)		54
55a	Investments—land, buildings, and equipment: basis 55a		
b	Less: accumulated depreciation (attach schedule) 55b		55c
56	Investments—other (attach schedule)		56
57a	Land, buildings, and equipment: basis 57a		
b	Less: accumulated depreciation (attach schedule) 57b		57c
58	Other assets (describe ►)		58
59	Total assets (add lines 45 through 58) (must equal line 75)		59
Liabilities			
60	Accounts payable and accrued expenses		60
61	Grants payable		61
62	Support and revenue designated for future periods (attach schedule)		62
63	Loans from officers, directors, trustees, and key employees (attach schedule)		63
64	Mortgages and other notes payable (attach schedule)		64
65	Other liabilities (describe ►)		65
66	Total liabilities (add lines 60 through 65)		66
Fund Balances or Net Assets			
Organizations that use fund accounting, check here ► <input type="checkbox"/> and complete lines 67 through 70 and lines 74 and 75 (see instructions).			
67a	Current unrestricted fund		67a
b	Current restricted fund		67b
68	Land, buildings, and equipment fund		68
69	Endowment fund		69
70	Other funds (describe ►)		70
Organizations that do not use fund accounting, check here ► <input type="checkbox"/> and complete lines 71 through 75 (see instructions).			
71	Capital stock or trust principal		71
72	Paid-in or capital surplus		72
73	Retained earnings or accumulated income		73
74	Total fund balances or net assets (add lines 67a through 70 OR lines 71 through 73: column (A) must equal line 19 and column (B) must equal line 21)		74
75	Total liabilities and fund balances/net assets (add lines 66 and 74)		75

Form 990 is available for public inspection and, for some people, serves as the primary or sole source of information about a particular organization. How the public perceives an organization in such cases may be determined by the information presented on its return. Therefore, please make sure the return is complete and accurate and fully describes the organization's programs and accomplishments.

Part V List of Officers, Directors, Trustees, and Key Employees (List each one even if not compensated. See instructions.)

(A) Name and address	(B) Title and average hours per week devoted to position	(C) Compensation (if not paid, enter -0-)	(D) Contributions to employee benefit plans	(E) Expense account and other allowances

Did any officer, director, trustee, or key employee receive aggregate compensation of more than \$100,000 from your organization and all related organizations, of which more than \$10,000 was provided by the related organizations? ☐ Yes ☐ No
If "Yes," attach schedule (see instructions).

Part VI Other Information

Note: Section 501(c)(3) organizations and section 4947(a)(1) trusts must also complete and attach Schedule A (Form 990).

	Yes	No
76 Did the organization engage in any activity not previously reported to the Internal Revenue Service? If "Yes," attach a detailed description of each activity.	76	
77 Were any changes made in the organizing or governing documents, but not reported to the IRS? If "Yes," attach a conformed copy of the changes.	77	
78a Did the organization have unrelated business gross income of \$1,000 or more during the year covered by this return?	78a	
b If "Yes," has it filed a tax return on Form 990-T, Exempt Organization Business Income Tax Return, for this year?	78b	
c At any time during the year, did the organization own a 50% or greater interest in a taxable corporation or partnership? If "Yes," complete Part IX.	78c	
79 Was there a liquidation, dissolution, termination, or substantial contraction during the year? (See instructions.) If "Yes," attach a statement as described in the instructions.	79	
80a Is the organization related (other than by association with a statewide or nationwide organization) through common membership, governing bodies, trustees, officers, etc., to any other exempt or non-exempt organization? (See instructions.)	80a	
b If "Yes," enter the name of the organization and check whether it is <input type="checkbox"/> exempt OR <input type="checkbox"/> nonexempt.		
81a Enter amount of political expenditures, direct or indirect, as described in the instructions.	81a	
b Did the organization file Form 1120-POL, U.S. Income Tax Return for Certain Political Organizations, for this year?	81b	
82a Did the organization receive donated services or the use of materials, equipment, or facilities at no charge or at substantially less than fair rental value?	82a	
b If "Yes," you may indicate the value of these items here. Do not include this amount as revenue in Part I or as an expense in Part II. See instructions for reporting in Part III.	82b	
83a Did anyone request to see either the organization's annual return or exemption application (or both)?	83a	
b If "Yes," did the organization comply as described in the instructions? (See General Instruction L.)	83b	
84a Did the organization solicit any contributions or gifts that were not tax deductible?	84a	
b If "Yes," did the organization include with every solicitation an express statement that such contributions or gifts were not tax deductible? (See General Instruction M.)	84b	
85a Section 501(c)(5) or (6) organizations.—Did the organization spend any amounts in attempts to influence public opinion about legislative matters or referendums? (See instructions and Regulations section 1.162-20(c).)	85a	
b If "Yes," enter the total amount spent for this purpose.	85b	
86 Section 501(c)(7) organizations.—Enter:		
a Initiation fees and capital contributions included on line 12	86a	
b Gross receipts, included on line 12, for public use of club facilities (see instructions)	86b	
c Does the club's governing instrument or any written policy statement provide for discrimination against any person because of race, color, or religion? (If "Yes," attach statement. See instructions.)	86c	
87 Section 501(c)(12) organizations.—Enter amount of:		
a Gross income received from members or shareholders	87a	
b Gross income received from other sources. (Do not net amounts due or paid to other sources against amounts due or received from them.)	87b	
88 Public interest law firms.—Attach information described in the instructions.		
89 List the states with which a copy of this return is filed		
90 During this tax year did the organization maintain any part of its accounting / tax records on a computerized system?	90	
91 The books are in care of Telephone no. Located at ZIP code		
92 Section 4947(a)(1) charitable trusts filing Form 990 in lieu of Form 1041, U.S. Fiduciary Income Tax Return, should check here and enter the amount of tax-exempt interest received or accrued during the tax year.		

(e)
Related or exempt
function income
(See instructions.)

(e) _____

Note: (Line 105 plus line 1d, Part I, should equal the amount on line 12, Part I.)

Line No.	▼	Explain how each activity for which income is reported in column (e) of Part VII contributed importantly to the accomplishment of the organization's exempt purposes (other than by providing funds for such purposes). (See instructions.)
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Line No.
▼End-of-year
assets

Title

ZIP code

Part IV Reason for Non-Private Foundation Status (See instructions for definitions.)The organization is not a private foundation because it is (please check only **ONE** applicable box):

- 5 ☐ A church, convention of churches, or association of churches. Section 170(b)(1)(A)(i).
- 6 ☐ A school. Section 170(b)(1)(A)(ii). (Also complete Part V, page 3.)
- 7 ☐ A hospital or a cooperative hospital service organization. Section 170(b)(1)(A)(iii).
- 8 ☐ A Federal, state, or local government or governmental unit. Section 170(b)(1)(A)(iv).
- 9 ☐ A medical research organization operated in conjunction with a hospital. Section 170(b)(1)(A)(iii). Enter name, city, and state of hospital ▶
- 10 ☐ An organization operated for the benefit of a college or university owned or operated by a governmental unit. Section 170(b)(1)(A)(iv). (Also complete Support Schedule.)
- 11a ☐ An organization that normally receives a substantial part of its support from a governmental unit or from the general public. Section 170(b)(1)(A)(vi). (Also complete Support Schedule.)
- 11b ☐ A community trust. Section 170(b)(1)(A)(vi). (Also complete Support Schedule.)
- 12 ☐ An organization that normally receives: (a) no more than 1/5 of its support from gross investment income and unrelated business taxable income (less section 511 tax) from businesses acquired by the organization after June 30, 1975, and (b) more than 1/5 of its support from contributions, membership fees, and gross receipts from activities related to its charitable, etc., functions—subject to certain exceptions. See section 509(a)(2). (Also complete Support Schedule.)
- 13 ☐ An organization that is not controlled by any disqualified persons (other than foundation managers) and supports organizations described in: (1) boxes 5 through 12 above; or (2) section 501(c)(4), (5), or (6), if they meet the test of section 509(a)(2). (See section 509(a)(3).)

Provide the following information about the supported organizations. (See instructions for Part IV, box 13.)

(a) Name(s) of supported organization(s)	(b) Box number from above

- 14 ☐ An organization organized and operated to test for public safety. Section 509(a)(4). (See specific instructions.)

Support Schedule (Complete only if you checked box 10, 11, or 12 above.) *Use cash method of accounting.*

Calendar year (or fiscal year beginning in) ▶	(a) 1991	(b) 1990	(c) 1989	(d) 1988	(e) Total
15 Gifts, grants, and contributions received. (Do not include unusual grants. See line 28.)					
16 Membership fees received					
17 Gross receipts from admissions, merchandise sold or services performed, or furnishing of facilities in any activity that is not a business unrelated to the organization's charitable, etc., purpose					
18 Gross income from interest, dividends, amounts received from payments on securities loans (section 512(a)(5)), rents, royalties, and unrelated business taxable income (less section 511 taxes) from businesses acquired by the organization after June 30, 1975.					
19 Net income from unrelated business activities not included in line 18					
20 Tax revenues levied for the organization's benefit and either paid to it or expended on its behalf					
21 The value of services or facilities furnished to the organization by a governmental unit without charge. Do not include the value of services or facilities generally furnished to the public without charge.					
22 Other income. Attach schedule. Do not include gain or (loss) from sale of capital assets.					
23 Total of lines 15 through 22.					
24 Line 23 minus line 17.					
25 Enter 1% of line 23					
26 Organizations described in box 10 or 11:					
a Enter 2% of amount in column (e), line 24					
b Attach a list (not open to public inspection) showing the name of and amount contributed by each person (other than a governmental unit or publicly supported organization) whose total gifts for 1988 through 1991 exceeded the amount shown in line 26a. Enter the sum of all excess amounts here ▶					

(Continued on page 3)

Part IV Support Schedule (continued) (Complete only if you checked box 10, 11, or 12 on page 2.)

- 27** Organizations described in box 12, page 2:
- a** Attach a list for amounts shown on lines 15, 16, and 17, showing the name of, and total amounts received in each year from, each "disqualified person," and enter the sum of such amounts for each year:
 (1991) (1990) (1989) (1988)
 - b** Attach a list showing, for 1988 through 1991, the name of, and amount included in line 17 for, each person (other than a "disqualified person") from whom the organization received more during that year than the larger of: (1) the amount on line 25 for the year; or (2) \$5,000. Include organizations described in boxes 5 through 11 as well as individuals. Enter the sum of these excess amounts for each year:
 (1991) (1990) (1989) (1988)
- 28** For an organization described in box 10, 11, or 12, page 2, that received any unusual grants during 1988 through 1991, attach a list (not open to public inspection) for each year showing the name of the contributor, the date and amount of the grant, and a brief description of the nature of the grant. Do not include these grants in line 15. (See specific instructions.)

Part V Private School Questionnaire
(To be completed **ONLY** by schools that checked box 6 in Part IV)

	Yes	No
29 Does the organization have a racially nondiscriminatory policy toward students by statement in its charter, bylaws, other governing instrument, or in a resolution of its governing body?	29	
30 Does the organization include a statement of its racially nondiscriminatory policy toward students in all its brochures, catalogues, and other written communications with the public dealing with student admissions, programs, and scholarships?	30	
31 Has the organization publicized its racially nondiscriminatory policy through newspaper or broadcast media during the period of solicitation for students, or during the registration period if it has no solicitation program, in a way that makes the policy known to all parts of the general community it serves? If "Yes," please describe; if "No," please explain. (If you need more space, attach a separate statement.)	31	
32 Does the organization maintain the following:		
a Records indicating the racial composition of the student body, faculty, and administrative staff?	32a	
b Records documenting that scholarships and other financial assistance are awarded on a racially nondiscriminatory basis?	32b	
c Copies of all catalogues, brochures, announcements, and other written communications to the public dealing with student admissions, programs, and scholarships?	32c	
d Copies of all material used by the organization or on its behalf to solicit contributions? If you answered "No" to any of the above, please explain. (If you need more space, attach a separate statement.)	32d	
33 Does the organization discriminate by race in any way with respect to:		
a Students' rights or privileges?	33a	
b Admissions policies?	33b	
c Employment of faculty or administrative staff?	33c	
d Scholarships or other financial assistance? (See instructions.)	33d	
e Educational policies?	33e	
f Use of facilities?	33f	
g Athletic programs?	33g	
h Other extracurricular activities? If you answered "Yes" to any of the above, please explain. (If you need more space, attach a separate statement.)	33h	
34a Does the organization receive any financial aid or assistance from a governmental agency?	34a	
b Has the organization's right to such aid ever been revoked or suspended? If you answered "Yes" to either 34a or b, please explain using an attached statement.	34b	
35 Does the organization certify that it has complied with the applicable requirements of sections 4 01 through 4 05 of Rev. Proc. 75-50, 1975-2 C.B. 587, covering racial nondiscrimination? If "No," attach an explanation. (See instructions for Part V.)	35	

Part VI-A Lobbying Expenditures by Electing Public Charities (see instructions)
 (To be completed **ONLY** by an eligible organization that filed Form 5768)
Check here ☐ a If the organization belongs to an affiliated group (see instructions).Check here ☐ b If you checked a and "limited control" provisions apply (see instructions).

Limits on Lobbying Expenditures (*Expenditures* means amounts paid or incurred)		(a) Affiliated group totals	(b) To be completed for ALL electing organizations
36	Total lobbying expenditures to influence public opinion (grassroots lobbying)	36	
37	Total lobbying expenditures to influence a legislative body (direct lobbying)	37	
38	Total lobbying expenditures (add lines 36 and 37)	38	
39	Other exempt purpose expenditures (see Part VI-A instructions)	39	
40	Total exempt purpose expenditures (add lines 38 and 39) (see instructions)	40	
41	Lobbying nontaxable amount. Enter the amount from the following table— If the amount on line 40 is— The lobbying nontaxable amount is— Not over \$500,000 20% of the amount on line 40 Over \$500,000 but not over \$1,000,000 \$100,000 plus 15% of the excess over \$500,000 Over \$1,000,000 but not over \$1,500,000 \$175,000 plus 10% of the excess over \$1,000,000 Over \$1,500,000 but not over \$17,000,000 \$225,000 plus 5% of the excess over \$1,500,000 Over \$17,000,000 \$1,000,000	41	
42	Grassroots nontaxable amount (enter 25% of line 41)	42	
43	Subtract line 42 from line 36. Enter -0- if line 42 is more than line 36	43	
44	Subtract line 41 from line 38. Enter -0- if line 41 is more than line 38	44	

Caution: File Form 4720 if there is an amount on either line 43 or line 44.

4-Year Averaging Period Under Section 501(h)(Some organizations that made a section 501(h) election do not have to complete all of the five columns below.
See the instructions for lines 45–50 for details.)

Celerday year (or fiscal year beginning in) ▶	Lobbying Expenditures During 4-Year Averaging Period				
	(a) 1992	(b) 1991	(c) 1990	(d) 1989	(e) Total
45 Lobbying nontaxable amount (see instructions)					
46 Lobbying ceiling amount (150% of line 45(e))					
47 Total lobbying expenditures (see instructions)					
48 Grassroots nontaxable amount (see instructions)					
49 Grassroots ceiling amount (150% of line 48(e))					
50 Grassroots lobbying expenditures (see instructions)					

Part VI-B Lobbying Activity by Nonelecting Public Charities
 (For reporting by organizations that did not complete Part VI-A.)

During the year, did the organization attempt to influence national, state or local legislation, including any attempt to influence public opinion on a legislative matter or referendum, through the use of:

	Yes	No	Amount
a Volunteers			
b Paid staff or management (include compensation in expenses reported on lines c through h)			
c Media advertisements			
d Mailings to members, legislators, or the public			
e Publications or published or broadcast statements			
f Grants to other organizations for lobbying purposes			
g Direct contact with legislators, their staffs, government officials, or a legislative body			
h Rallies, demonstrations, seminars, conventions, speeches, lectures, or any other means			
i Total lobbying expenditures (add lines c through h)			

If "Yes" to any of the above, also attach a statement giving a detailed description of the lobbying activities.

Part VII Information Regarding Transfers To and Transactions and Relationships With Noncharitable Exempt Organizations

51 Did the reporting organization directly or indirectly engage in any of the following with any other organization described in section 501(c) of the Code (other than section 501(c)(3) organizations) or in section 527, relating to political organizations?

a. Transfers from the reporting organization to a noncharitable exempt organization of:

		Yes	No
a. Transfers from the reporting organization to a noncharitable exempt organization of:			
(i) Cash	51a(i)		
(ii) Other assets	a(ii)		
b. Other Transactions:			
(i) Sales of assets to a noncharitable exempt organization	b(i)		
(ii) Purchases of assets from a noncharitable exempt organization	b(ii)		
(iii) Rental of facilities or equipment	b(iii)		
(iv) Reimbursement arrangements	b(iv)		
(v) Loans or loan guarantees	b(v)		
(vi) Performance of services or membership or fundraising solicitations	b(vi)		
c. Sharing of facilities, equipment, mailing lists, or other assets, or paid employees		c	

d. If the answer to any of the above is "Yes," complete the following schedule. The "Amount involved" column below should always indicate the fair market value of the goods, other assets, or services given by the reporting organization. If the organization received less than fair market value in any transaction or sharing arrangement, indicate in column (d) the value of the goods, other assets, or services received.

[illegible]

52a Is the organization directly or indirectly affiliated with, or related to, one or more tax-exempt organizations described in section 501(c) of the Code (other than section 501(c)(3)) or in section 527? ☐ Yes ☐ No

b. If "Yes," complete the following schedule.

[illegible]

Exempt Organization Staffing

Field EO Technical Staffing

	<u>Determinations</u>	<u>Examinations</u>	<u>Total</u>
<u>FY 1989</u>	112	417	529
<u>FY 1990</u>	106	395	501
<u>FY 1991</u>	108	378	486
<u>FY 1992</u>	118	391	509
<u>FY 1993</u> (planned)	111	394	505

National Office EO Technical Staffing (exclusive of Counsel)

<u>FY 1989</u>	140
<u>FY 1990</u>	124
<u>FY 1991</u>	122
<u>FY 1992</u>	134
<u>FY 1993</u>	125

Chairman PICKLE. Commissioner, I appreciate your testimony. I appreciate your forthright statements and your clear indication that you want to find better procedures than you are using now. None of us on this committee want to do damage to tax-exempt organizations, but if there is abuse out there in this vastly growing procedure, we had better find a way to control it. Otherwise, the bad actors are going to poison the well for everybody else and that would be regrettable.

I was encouraged by your statement. I don't want to ask a lot of questions, but I notice on page 16 that you make the statement, "To assure such consistency, we believe that it would be useful to provide us with sanctions short of revocation to address violations of the standards for tax exemption."

You had said on the previous page that you looked to Congress for direction. I take that you are suggesting that the Congress could make a recommendation to you, and you would respond to it and would help us work out whatever position we take?

Ms. RICHARDSON. We would like very much to work with you and with Treasury. We have not had a chance to sit down with the new administration and work out specific recommendations for you in terms of sanctions.

Chairman PICKLE. Neither has this committee, but we have some very definite feelings and I think we are traveling on parallel roads to reach a conclusion.

Ms. RICHARDSON. I think we are both looking——

Chairman PICKLE. As we proceed with other hearings, we will concentrate on ways to do a better job. It bothers me though that you talk about your CEP program, which is primarily designed for the big organizations and you want experts, trained personnel and auditors to be involved, and perhaps that is a good approach for the larger organizations. But it doesn't answer the question that bothers me, which is in my opening statement. That is tax-exempt status granting has tripled in the last few years. My question first is do you, the IRS, do you have the resources, the means, the personnel, and the technical resources to handle the problems you face now?

Ms. RICHARDSON. I would be less than honest if I told you we had all the resources we would like to have to handle everything we are asked to handle.

I will ask Mr. Burke to answer what kind of resources we have been applying in this area.

Mr. BURKE. We had a modest size audit program. We have some 500 people in the field who provide the examination program for exempt organizations. We could use some more resources, but it would be a small increase because we would have to deal with growing pains.

I think the more important question is can we deliver an effective program with what we have. The answer I believe is yes. If we got more, we could increase the effectiveness of such a program, but it would have to be a modest increase of maybe 30 to 40 staff years to be able to absorb it.

I think at the present time our focus, which is on the larger exempt organizations, is appropriate. I think in order to get into the smaller organizations we have got to develop probes as opposed to

full-scale audit programs. We have such probes included in our fiscal year 1994 work plan which allows us to begin to segment the universe for some of the smaller organizations and be able to do statistical sampling techniques to be able to report the extent of noncompliance in the smaller organizations along with what we are doing in the larger ones.

Chairman PICKLE. I said that IRS has fewer employees monitoring nonprofits than in 1980. Is that correct?

Mr. BURKE. I believe it is. We have 506 in the field now and I believe around 1980 it was slightly more than that.

Chairman PICKLE. I said that funding for the EP/EO Division has declined. Is that correct?

Mr. BURKE. In actual dollars it has gone up, but I guess in inflationary dollars it might be slightly less.

Chairman PICKLE. I have said that tax-exempt audits have declined. Is that correct?

Mr. BURKE. That is correct.

Chairman PICKLE. Each year we are adding 30,000 more public charities. Your answer to me is that we could use some more people, but it would have to be slow because we have to wrestle with growing pains. I find that unacceptable.

Do you need personnel or not? I would think that growing pains would be a welcome addition to the problem you have instead of an obstacle. You have less people with less money to do more work. We have over 1.1 million tax-exempt organizations.

Now, I would think that common sense would tell you that you have to have more people and you have to attack the problem with vigor.

Mr. BURKE. I would agree that we could use more people. I would agree that we can attack the problem with more vigor, but I have to share with you the discomfort I feel with the number of exempt organizations that we have on our exempt organization master file.

What I mean when I say I feel a certain degree of discomfort is the fact that the master file represents a total accumulation of organizations that have been granted exempt status. It has not been purified in terms of those organizations that might have gone out of existence because the charity for which they were originally formed is no longer a need in the community.

Chairman PICKLE. I think we have to admit, all of us, that once a tax-exempt organization gets on the book, it normally stays there forever, until Gabriel blows his horn. Some do go off and some expire, I suppose, but for the most part they are out there unattended. We have to find a better way to handle them.

It seems to me that the most serious problem we have is that you can't function with a clear conscience when your only weapon is revocation of exemption. You said that the Commissioner said that that is the only weapon she has and it puts her in a very uncomfortable position.

Do you agree that in addition to revocation, we should have some kind of graduated sanction?

Mr. BURKE. Completely.

Chairman PICKLE. I am glad to hear that.

Mr. Houghton.

Mr. HOUGHTON. I have several questions. I want to follow through on the resources, but also I will take a bit of liberty with this, Mr. Chairman, everybody needs more people. Everybody needs more emphasis as the country gets larger and tax forms get more numerous.

You have suggested various things which I believe are good: the concept of a probe versus a full-scale audit, the concept of a sanction versus a revocation; the concept of disclosure, little things like that.

Tell me about that. Would that be effective rather than just doing things the way you have done them before and put whole armies of new people on this problem?

Ms. RICHARDSON. Yes, we think that each of those measures would be very effective. As I mentioned in my testimony, the notion of having to have a choice between walking away and revoking an exemption is extreme and it puts us in a very awkward position vis-a-vis the charities and the people who are intended to benefit.

It makes it very difficult if we have to revoke the exemption. Disclosure we think is an effective tool. I do not think that is the only sanction we should be considering but disclosure certainly doesn't hurt. The idea of the problem—I will let Mr. Burke address that because he has given it more thought than I have.

We think that, too, would be an effective way to approach smaller organizations.

Mr. BURKE. We also recognize we are in an environment where there is a desire to cut down on government regulations and cut down on government employment as a matter of fact. So we recognize that. We recognize that this is not a period of time to be coming in with massive requests for increases in resources, human resources.

So as a result we are attempting to use what is available to us to be able to deal with an area of noncompliance so that I agree that we shouldn't have armies of revenue agents out there examining exempt organizations. I don't think there is a need to examine every exempt organization. I think a modest presence is what we need because for the most part exempt organizations want to comply with the laws and our job is to ferret out those that don't want to comply and don't comply, but for those that do, to provide assistance to them so they know what the laws require and they can comply with the laws.

Mr. SCHOENFELD. I would like to add that if the IRS is to be effective in this area, it needs effective enforcement tools. What is lacking is an enforcement mechanism scheme under present law. If the IRS is going to be credible in its enforcement actions, it needs to have appropriate sanctions that are applicable to the misconduct.

Mr. HOUGHTON. I have another question which gets off the reservation a little bit, but I will ask it anyway. As a Congressman, an elected Representative, we are always barraged by people who want to do good things in the community. Really the question is to the extent of the lobbying pressure as well as the pressure which we in Congress put on you. Because we ask you to do certain things and yet at the same time we are trying to protect those

things which we feel are beneficial in a variety of different ways in our communities.

Do you get a sense of undue pressure from Congress on this?

Ms. RICHARDSON. I can only speak for the last 2 months and I can say unequivocally no. I have not sensed that we have gotten undue pressure from Congress or anyone else for that matter.

Mr. BURKE. I have not felt in the 2 years I have been back here that there has been undue pressure from Congress with respect to the public charity enforcement program. I do recognize that Congress has expressed a continuing interest in how good a job we do, but I haven't felt that that was undue pressure.

Mr. HOUGHTON. Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Brewster may inquire.

Mr. BREWSTER. Thank you, Mr. Chairman.

I understand that the IRS does have fewer employees in this particular division than it did in 1980, yet I notice that the IRS total number of employees is up significantly.

What is the rationale that fewer would be in this particular arena?

Mr. BURKE. I think over the past 10 to 12 years anyway, say in the last decade, the thrust of our resource applications have been in what might be called a return on your investment, and the request for additional resources have primarily gone to those areas that seem to generate the greatest amount of revenue.

Exempt organizations is not a revenue-raising operation. Our enforcement programs are designed to assure that the exempt organizations deliver on the functions for which they were granted exempt status. So as a result, the application of the additional resources that we have received have gone more into individual income tax and corporate tax enforcement programs.

Mr. BREWSTER. But is it not possible that abuse within this particular form of organization when you are adding 30,000 a year could be far greater than what you could capture from individual or corporate income tax?

Mr. BURKE. I think that is a legitimate question. We have to look at that. In the past couple of years, we have started to allocate more staff to exempt organizations.

I come back to the comment I made earlier—a modest increase because we have to do this in terms of understanding the universe of exempt organizations and how many of them are large and their impact on society.

Mr. BREWSTER. Is there a particular type of charity that is a more frequent violator than other types of charities from your audits?

Mr. BURKE. There are a number of different kinds of charities. When we use the term public charities, we include groupings such as health care services, including hospitals. We are talking about religious activities such as media televangelists and we are talking about what is conjured up in the normal concept of public charities, activities such as the Red Cross and things of that sort.

I would say that as we move into the larger organizations, we are seeing a greater degree of questions with respect to inurement or self-dealing. The percentage of changes or questions we are rais-

ing seem to be coming up more with groupings such as health care operations and media televangelists.

Mr. BREWSTER. Approximately one quarter of all public charities file tax returns. How many of the charities not filing tax returns would be churches? Any idea?

Mr. BURKE. We have a figure that was referred to I think in the Congressman's opening statement of 330,000 churches. I would estimate that that is approximately accurate.

Mr. BREWSTER. OK.

Mr. BURKE. That includes not only the mainstream religions, but the various parishes and individual churches within the larger denominations.

Mr. BREWSTER. If someone other than a church doesn't file a report, how do you know their annual income is below the \$25,000 filing requirement?

Mr. BURKE. You have hit me in a soft spot because frankly, the answer is at this point our followup program for organizations with receipts under \$25,000 needs to be strengthened.

The difficulty we have, is as I may have mentioned earlier, when we recognize exempt status for the various charities, we put them on the master file and when they do phase out of existence we do not have an effective followup program to purify the master file.

For example, if I might give you an illustration, a number of organizations and charitable activities came into existence during the Middle East crisis a couple of years ago. A number of concerned citizens formed charities to provide support to the troops overseas in various ways.

After the conflict was resolved, those charities, many of them, phased out of existence and did not notify us. We do not have that strong a followup system, and I might state, nor do we have the resources at the present time to be able to do that kind of effective followup.

So it gives me a little bit of concern as to actually how many exempt organizations we have on the master file are really represented by the 1.1 million.

Mr. BREWSTER. So if an organization had \$200,000 or \$300,000 income and either neglected to file or chose not to intentionally, it would be very difficult for you to know that?

Mr. BURKE. It would be difficult. We have a program being put in place now which would allow us to identify that kind of nonfiler to a much greater degree than we have in the past by using statistical sampling.

Mr. BREWSTER. You have been reporting to the subcommittee about IRS examination, collection and criminal investigation activities involving television evangelists.

In IRS's most recent report on media evangelists dated April 21, 1993, IRS describes a case, X-14, where five individuals, an organization claiming church status and two related taxable entities, are under examination.

In the case, the IRS proposes to revoke the exempt status in view of private inurement, substantial expenditures for nonexempt purposes, and significant commercial activities.

What sort of transactions or activities took place?

Mr. BURKE. I think the issues that the Congressman is referring to are issues that we can talk about. I am precluded by section 6103 from getting into specific case identification or anything that could be construed as specific individual identification. But the issues that came up in the illustration that you posed do raise questions of inurement. They raise questions as to whether or not a particular charity or activity is actually delivering on the exempt functions for which it was recognized exempt and whether or not the benefits or the assets or the receipts that flow through that particular organization are going to the benefit of an individual. When that happens, what we are faced with is, as we indicated earlier, revocation under present law or finding some other way to resolve the controversy and allow the organization to continue to operate.

In this case, I would think that the illustration you mentioned we may have to look very hard at revocation.

Mr. BREWSTER. A couple more points.

I noticed the president of a school received a salary of \$365,000 and a loan of \$1 million. That is a 50-year interest free loan, \$500,000 to buy a home and \$500,000 to renovate it. That concerns me.

Is IRS concerned about that?

Mr. BURKE. We would be concerned about interest-free loans, but we also have the issue of imputed interest that becomes taxable to the individuals. We would have to assure as part of our examination program that the individuals who may have received interest-free loans are reporting the forgiven interest on their tax returns because the Code provision does require that the imputed interest be picked up on the individual return.

The question of what kind of fringe benefits or disguised benefits become part of a compensation package all become part of the issue we have to address in terms of whether the compensation is excessive and then whether or not the excessive compensation is so substantial that we should consider revocation of the organization, a very difficult, time-consuming process, which is why we see interim or alternative sanctions as being a better alternative to what we have.

Mr. BREWSTER. One more point.

I served on a hospital board for 10 years and I see that a particular hospital has \$1.5 million out in loans to officers, directors and employees. That concerns me and makes me wonder some about the exempt status of a lot of organizations.

Would you like to comment?

Mr. BURKE. With respect to the issue of significant amounts of a charitable activity's assets being distributed to individuals and becoming part of either a fringe benefit compensation package or some other way of distributing the assets to a private individual—those are the kind of issues that concern us a great deal.

Mr. BREWSTER. But it is legal for them to make loans to officers and directors of the foundation?

Mr. BURKE. There is nothing illegal or any Internal Revenue Code provision that I am aware of that would preclude loans to employees of an exempt organization.

Mr. BREWSTER. Maybe there should be.

Mr. BURKE. Which is a public charity—I am sorry.

Chairman PICKLE. Should we put a change in the law saying that that kind of interest-free loan would not be favorable?

Mr. BURKE. I am not sure that we are in a position right now to make a policy choice as to whether or not that sort of proscription should be introduced into the Internal Revenue Code. I think that is an area that perhaps our colleagues at Treasury, your subcommittee and we could talk about, but I am not sure that introducing proscriptions on loans is appropriate in view of what we have found so far.

Chairman PICKLE. We are going to ask you specifically later so you can have a positive position. Mr. Brewster asked you a minute ago in what type of charities were there more abuses perhaps than in others. You talked in terms of the problems, inurements and self-dealing, and then you concluded that we find these kind of violations more in the area of health care organizations and TV evangelists.

When you say health care associations are you including hospitals?

Mr. BURKE. What I was referring to is the percentage of questions and issues that have come up in our examinations of health care operations which include hospitals. I did not mean at this point to be saying that we found a significant number of abuses with the hospitals. We have had a significant number of issues come up.

With respect to televangelists, frankly the percentage of examinations we have done has given us at least a feeling of discomfort that there seems to be a higher degree of inurement among that group than there are in other charitable activity groups.

Chairman PICKLE. Well, let me try again with you, Mr. Burke. In what areas are the worst violations, TV evangelists?

Mr. BURKE. I don't think any—

Chairman PICKLE. Hospitals? Colleges?

Mr. BURKE. I think no area is immune to the question of inurement or self-dealing.

Chairman PICKLE. Commissioner, in what areas are more violations occurring?

Ms. RICHARDSON. I think that our program, as I indicated, has gotten under way in the last fiscal year and we are trying to compile some statistics and I am not sure that I am comfortable telling you one area is more abusive than the other. Obviously you have heard a lot about certain areas such as the ones mentioned here today, but whether we could say categorically without equivocation that in one area we found more abuses than another I don't—

Chairman PICKLE. I don't know that we will reach a helpful conclusion by saying who is more guilty than others. We know that probably in the areas of TV evangelists and hospitals and universities, we have more opportunity for inurement and probably more violation in those fields than in others.

Is that generally an accurate statement?

Ms. RICHARDSON. In areas where there is more money flowing in, there is more opportunity for that kind of thing. I don't know that we are prepared to say that hospitals are more abusive than universities or that universities are more abusive than hospitals.

It is clear from information this committee has been reviewing that there are significant salaries being paid to people in those organizations.

Chairman PICKLE. I am going to come back to you for some specific examples of abuses. You mentioned four or five cases where you revoked exemptions. Where are the abuses? I will call upon you to recite abuses in a minute.

Mr. BREWSTER. One more question. I asked a moment ago about loans, if that was legal. It is my understanding if it were a private foundation, loans could not be made to officers, directors, et cetera; but a public charity, they can be made to officers, directors, et cetera?

Mr. BURKE. That is correct, yes.

Mr. BREWSTER. But if it were a private foundation, they could not be?

Mr. BURKE. They could become subject to the excise taxes that are imposed on private organizations because it is self-dealing.

Mr. BREWSTER. That seems inconsistent to me. What is the rationale for the inconsistent treatment?

Mr. BURKE. I think it is a question of the issues that came up when the private foundation excise taxes were introduced in 1969. I think the congressional concern at that time was more with abuses they were hearing about with respect to private foundations.

Foundations had accumulated significant amounts of wealth. There were charges and indications that they weren't distributing their assets for charitable purposes and there were charges and concerns that much of the assets were being used for the benefit of the foundation managers or other people who were insiders within the foundations.

Rather than take a shotgun and hit all the exempt organizations, I believe the Congress at that time decided to focus on private foundations and that is why the chapter 42 sanctions were imposed just with respect to foundations.

Mr. BREWSTER. Is there any reason why we should not look at legislation that would preclude a hospital or other public charity from lending in this case \$1.5 million to officers, directors and employees?

Mr. BURKE. I hesitate to tell you because I have never worked within a hospital or an exempt organization of any size. Consequently I am not sure what their needs might be in that respect, so I hesitate to make such an unequivocal recommendation.

Mr. BREWSTER. Our hospital is trying to keep its doors open. It amazes me that someone has that kind of money to lend.

Mr. MCGOVERN. Could I follow up on that? I agree with Mr. Burke, but if we are talking about a nonprofit tax-exempt hospital that is making loans to officers, directors or employees, these are individuals who would be considered insiders under the tax law. As such, they would be subject to the inurement proscription. The provision of interest-free loans to insiders would be a red flag on audit and would be looked at carefully. In each instance the total compensation package would be analyzed.

From what you are reading in the media today, those packages are all encompassing. That would be a factor that would be brought

into the equation as to whether the compensation was reasonable. If a determination was made that the compensation was unreasonable and the person receiving the loan was an insider, the hospital's tax exemption would be in jeopardy. That of course leads us back to the only remedy available to the tax administrator—revocation of tax exemption. There is no sanction on the insider who got excessive compensation.

Mr. BREWSTER. Rather than go that roundabout way, is there any reason we should not make it illegal for a public charity to loan money to directors or officers? Why shouldn't they go to the bank and borrow money as I do?

Mr. MCGOVERN. I think that is an issue that is open to fair consideration. Our statement for the record and the Commissioner's oral testimony makes it clear that we think intermediate sanctions would be helpful in this area.

Chairman PICKLE. Mr. Hancock.

Mr. HANCOCK. One of the questions I had, Commissioner, is you mentioned that only 23 percent of the public charities that report on form 990 have assets in excess of \$1 million. Did you mean assets or revenues?

Ms. RICHARDSON. Actual assets.

Mr. HANCOCK. Could you give me a percentage of the ones that had revenues in excess of \$1 million or a breakdown of those revenue figures?

Mr. BURKE. We do not have the revenue figures or receipt figures here right now. We would have to provide that at a later time.

Mr. HANCOCK. OK.

[The information follows:]

Only 19.5 percent of the public charities that are required to file have revenues in excess of \$1 million. The revenue reported by these public charities represents 94.1 percent of the revenue reported by public charities.

EO Statistical Table 1				
Forms 990 Posted To EO/BMF By				
Income Range/Code				
* Income Range/Code	** 1992	%	** 1991	%
Less Than \$1 Million (0-5)	344,445	87.7	333,939	87.9
1 mil. - 4,999,999 (6)	32,608	8.3	30,970	8.2
5 mil. - 9,999,999 (7)	6,464	1.6	6,444	1.7
10 mil. - 49,999,999 (8)	6,510	1.7	6,051	1.6
50 mil. & Greater (9)	2,576	0.7	2,337	0.6
Total	392,603	100.0	379,741	100.0
Percent (%) of Returns Over \$1 Million		12.3		12.1

* Asset Code Ranges were revised as indicated above for process years 1991 and 1992.

** Figures represent all Forms 990s processed and posted to the Business Master File for these process years (Jan. - Dec.).

EO Statistical Table 1				
Forms 990 Posted To EO/BMF By				
Asset Range/Code				
* Asset Range/Code	** 1992	%	** 1991	%
Less Than \$1 Million (0-5)	340,125	86.6	330,020	86.9
1 mil. - 4,999,999 (6)	34,156	8.7	32,204	8.5
5 mil. - 9,999,999 (7)	7,170	1.8	7,003	1.8
10 mil. - 49,999,999 (8)	8,029	2.1	7,531	2.0
50 mil. & Greater (9)	3,123	0.8	2,983	0.8
Total	392,603	100.0	379,741	100.0
Percent (%) of Returns Over \$1 Million		13.4		13.1

* Asset Code ranges were revised as indicated above for process years 1991 and 1992.

** Figures represent all Forms 990s processed and posted to the Business Master File for these process years (Jan. - Dec.).

Mr. HANCOCK. We are talking about the cumulation of assets.

Ms. RICHARDSON. Yes, sir.

Mr. HANCOCK. One of the things I have wondered about is a not-for-profit charitable organization accumulating assets. That sounds to me like they are making a profit. If they accumulate assets there has to be a way for them to make a profit.

Ms. RICHARDSON. They may actually begin—

Mr. HANCOCK. If you are not-for-profit and you are a charity, it seems to me that you ought to be spending all the money you take in.

I understand. Let me ask another question. How many of the ones that you examine are primarily dependent upon government transfer payments for a major part of their revenues? In other words, how many of them get government grants, government subsidies? I am talking about the hospitals and what have you?

Mr. BURKE. Again, we don't have the specific percentage or numbers, but to give you a perspective, most of the larger universities have some sort of a contract with the government in connection with scientific research programs that they conduct. You would have a fair number of other organizations that qualify as public charities that also would have contracts with the government.

Mr. HANCOCK. Hospitals are getting substantial funds from the government.

Mr. BURKE. Yes, sir. There would be some government contracts with many of the hospitals.

Mr. HANCOCK. How many of the TV evangelists get money from the government?

Mr. BURKE. I don't think I can answer that. I am not aware that any that we have looked at have contracts with the government.

Mr. HANCOCK. Tax-free status itself is a subsidy by government. The government is also contributing money which it would appear to me that if in fact the Federal Government is going to give a subsidy through charitable-type vehicles, then there are certain rules we ought to talk about. Also if in fact we were contributing taxpayer money to those charitable organizations doesn't it also behoove us to take a very close look at not only their tax-free status, but what they are doing with the government money that they get?

We talk about a hospital loaning money to a charitable organization, loaning money to doctors and then we find that possibly 40 percent of that hospital's revenues are coming from the taxpayers. Pick a figure. A substantial part of that hospital's revenues are furnished by the Federal or State Government.

I believe, Mr. Chairman, that we are into something that is quite frankly, much bigger, much broader. In my judgment, you get into this area that if government needs x number of dollars, as soon as you start giving certain people exemptions that means you have to raise the rate on everybody that is left.

I am not saying that I am against charities, because I contribute money to charities. Frankly, I have never contributed money merely on the basis that it was tax deductible.

So I have one final question for you, and this will be the philosophical question. In your judgment, just by what you have been into, how many of these charities would not exist if in fact it wasn't for tax-free treatment?

In other words, is it truly a charity or is it a way to say I can raise money tax free and it is an easy way to raise money? I am not talking about the hospitals. I am talking about this guy making \$400,000 a year; is he really interested in educating people or is he interested in making money?

How many people are there that wouldn't pursue the activity if it weren't for the tax structure?

Ms. RICHARDSON. I don't think we can answer that question. I think it is an interesting question.

Mr. HANCOCK. It just seems to me that many times we have situations all over the country where someone wants to do a lot of good for a lot of people as long as he is getting paid to do it. If he is not getting paid to do it, he is not interested in helping out these people.

Charity used to be a good word. It is getting so it isn't such a good word any more.

Chairman PICKLE. Mr. Schoenfeld.

Mr. SCHOENFELD. Perhaps to clarify concerning whether or not TV evangelists might be in receipt of government funds? It is very possible that some evangelist organizations conducting food distribution programs to the needy here in the United States or abroad may be involved with governmental programs.

Mr. MCGOVERN. Could I respond? One of the things we are cognizant of is that we generally see the bad actors. No one parades a list of those exempt organizations that are doing good in front of us.

In our statement for the record, we pointed to the instance last year where citizens in Florida and Louisiana were faced with the devastation of Hurricane Andrew. There was a proud moment for many of us who are involved in charities in one way or another, including as regulators, when the former President, on national television, told citizens that the military and civilian arms of the government were mobilizing to help. At the same time, he made it clear that the Nation's churches and charities were doing the same.

There is a lot of good out there, but it would be less than fair to say that we are not concerned about the abuses.

Mr. HANCOCK. The point that I am trying to make—the abuses, it is like gun control. Abuse of guns is why we end up with laws to affect the people who actually don't need the laws. This is one of the things that the Chairman mentioned, 30,000 new ones a year.

There may be something here where it is being used to the benefit of certain people. After all, the function of tax attorneys and CPA's is to figure out how to spend a lot of time trying to keep it from happening.

Chairman PICKLE. Mr. Herger may inquire.

Mr. HERGER. Thank you, Mr. Chairman.

Mr. Burke, in your opinion, compared with the other tax enforcement issues, how serious is this matter of violations of tax-exempt rules, the relative problem that you see at the IRS and tax evasion areas?

Mr. BURKE. I would have to say we don't have quite as much data with respect to compliance by exempt organizations as I think we do with respect to individual and corporate tax matters. The

thing we do know is the point that both Mr. McGovern and Mr. Schoenfeld made.

From our experience over the past decade particularly, we have found that most of the exempt organizations and clearly most of the public charities want to comply and do comply and they deliver on the exempt functions for which they are granted exempt status.

We are talking about the few organizations that do engage in activities that result in a diversion of assets or receipts from what the public intends when they make their contributions.

Mr. HERGER. So the question is really to what extent do we know there are people out there in these areas who are abusing the system. Do I understand you to say that maybe we don't have as much information on this as we do on, for example, some of the corporate and other areas?

Mr. BURKE. That is true. We have not conducted the same kind of statistical sampling procedures, such as our taxpayer compliance measurement program, with respect to exempt organizations, as we have in the individual and the corporate tax area.

We do have some statistical sampling techniques that we are beginning to employ now and I would be able to give you a better read on this hopefully during the next year.

Mr. HERGER. So, therefore, you may not really be aware of the magnitude of how serious or nonserious this issue or problem may be at this time?

Mr. BURKE. I think that is a fair statement. The depth of this is not something that I would be willing to talk with any certainty about. The only thing I can talk with some certainty about is the fact we have found some pretty serious abuses of self-dealing and inurement, particularly in the last couple of years.

Mr. HERGER. Let me now refer to a series of newspaper articles that you may be aware of. The Philadelphia Inquirer published a series of six articles from April 18 to April 24 of this year about the activities of tax-exempt organizations.

The newspaper's 18-month study included the examination of tax returns of 6,000 exempt organizations and the article states that many nonprofits operate just like for-profit businesses. "They make huge profits, pay handsome salaries, build office towers, invest billions of dollars in stocks and bonds, employ lobbyists and use political action committees to influence legislation."

Are you familiar with this series of articles?

Mr. BURKE. Yes, sir, I am.

Mr. HERGER. What is your reaction?

Mr. BURKE. I think the series of articles raised legitimate issues for public debate such as we are having today. I think I would have some reservations in going as far as I think the articles did in drawing conclusions from what they looked at and making judgments as to the extent of inurement or self-dealing as a result of looking at 990s.

But I do think that the articles raise some valid issues and issues that do have to be addressed.

Mr. HERGER. I would agree with that and particularly in light of your earlier comment that perhaps the IRS really does not know exactly where we are in this area. It certainly is a concern to a number of people, and particularly those who want to be chari-

table, who want to help out, who want to do their share, but not knowing whether or not their dollars are being spent wisely or unwisely. This certainly leaves pressure and certainly creates concern on my part that the IRS be very active in this area. Perhaps you do not know at this time, but we at least may be considering what I believe the chairman was alluding to earlier. That is, if you don't have the manpower, the people to investigate this, perhaps you should look at this very seriously.

There is another part of this article that I would like to have your comment on. They mentioned they found dozens of cases where directors and executives of these nonprofit institutions own or are officers of outside companies that do business with these nonprofits. I was wondering, is the IRS finding this to be the case?

Mr. BURKE. We have found cases where there has been insider dealing. The issue then gets us back to what do we do when we find self-dealing with insiders within the organization or relatives and we come back to the issue of to what extent has this benefiting of an individual been substantial or less than substantial, because that is where we begin to have the impact on the organization.

If I can just take a moment and expound a little bit so it doesn't look like the Keystone Kops here. I want to make a point and the point is that we are looking at the largest organizations in this country and I think you will find over the past couple of years, our coordinated examination program is revealing an awful lot in terms of abuse, but also in terms of good charitable activities that are being carried on.

So I think what we have to do is see if we can put together something to address those that do engage in abusive transactions, that do cause inurement of benefits outside of the public charity and, at the same time, not impose any restrictions on the good that charitable organizations do.

I must say that I do feel a degree of pride in terms of the fact that I think we are addressing or focusing our resources to the extent that we have them in the right direction and that is the larger organizations.

Mr. HERGER. I have a last quick question for the Commissioner. I certainly would be interested and I know I have heard the chairman say the same of having recommendations from you, on what you believe we need to be doing. So perhaps at some of the next meetings we have together we can feel we are more informed about where we are in an area that is so very important. Again, just stressing it, when people have a doubt about whether or not their money is being used wisely, whether or not it is being used for someone's own self-gain, that obviously hurts all the charities. People will certainly not be contributing as much as they would otherwise.

So it is very important we get on top of this. You are the agency that is closest to the action and, therefore, I would also be very interested in seeing, as I know the chairman has indicated, recommendations that you have that we in the Congress can do to help you carry out this goal.

Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Herger had made reference to a series of articles published in the Philadelphia Inquirer. Our committee was

furnished some copies of it. I would make reference to the articles called "Warehouses of Wealth: The Tax-Free Economy."

This is a dissertation examining tax-free nonprofit organizations mostly in the Philadelphia area. It touches on the problem nationwide, but it is mainly just in that one area.

It is a definitive article, and whether you are for or against it, it is the most incisive examination of the question I have seen to date. We have asked for some extra copies. I have extra copies over on the desk somewhere here. These articles were written by a Mr. Gilbert Gaul and Mr. Neill Borowski. Is either Mr. Gaul or Mr. Borowski here? I understood that they were here.

Do you have copies of the Inquirer? If they want it afterward, would you make a copy available to them as long as you have copies? Is either reporter or anyone in attendance.

Stand up please so they can take a look at you.

Thank you very much.

Now, Mr. Jefferson.

MR. JEFFERSON. Thank you, very much, Mr. Chairman. I don't know if you did those men a favor or not by introducing them in this crowd.

Let me ask just a few questions. I think most of the important ones have already been inquired about, but just a few.

There has been a lot of talk about private inurement and I want to know what—and you mentioned something, Mr. Burke, about the coordinated examination program. I am not quite sure what that was, or what that is, but I want you to explain to me how you go about identifying the private inurement issue as you go about your work?

How do you identify this; what process or standards do you use? How do you catch it?

MR. BURKE. When we are doing the examination there are certain areas that we will look to. They include compensation packages, they include dealings within the organization between people who have some control over the exempt organization, whether they are directors or employees or people who have some influence over it, and it is a question of whether or not the individuals who have control over the organization are attaining some sort of measurable benefit in terms of the use of the organization's assets or receipts to inure to their own benefit.

If I may, I might ask Mr. Schoenfeld to see if he could provide more specific examples.

MR. SCHOENFELD. The whole question of private inurement is a fundamental issue in any examination of a public charity exempt under section 501(c)(3). I think the Service thanks this subcommittee in particular for some useful help that you gave us back in 1987 when you changed the laws relating to the reporting of transfers, transactions, and relationships by a charity with noncharitable organizations.

As a result of the law changes in that year, a significant addition was made to the IRS form 990 which does provide for a disclosure of these kinds of transactions. That is a very useful, helpful tool for the Internal Revenue Service and for the public in better understanding the transactions that take place.

This is just the first step. But this is a first step that the Service would look to in a particular case to determine whether or not a transaction is or is not abusive such that enforcement action might be appropriate in that case.

Mr. JEFFERSON. In the case of every form 990 that is filed, do you use some sort of audit procedure to deal with these filings? You don't look at every one of them?

Mr. SCHOENFELD. There is a process for the selection of cases by the Internal Revenue Service. Each year we develop our work plan, and we identify the areas of emphasis, the areas that are to be targeted that year so that we can best allocate the resources that are available to us.

Our first priority over the most recent couple of years has been in the area of the coordinated examination program and these involved the largest cases that Mr. Burke had described to you, and this is one area of attention, but there are other areas of attention that we look at as well, and these would include problems relating to unrelated business income tax; issues relating to lobbying activities, and we have also included media evangelist cases as an area of emphasis in our examination programs. This is what we use as the basis for the selection of returns or organizations for audit, and each year it is evaluated to see if this is the best use which should be continued.

Mr. JEFFERSON. Once you have selected the forms or the companies that file the forms that you are going to take a close look at, the standards that you use, are they objective standards used in every case or only ones used in the judgment of the person working on the matter?

Is there some checklist formulated somewhere that everybody uses; regulations that govern how you do it or just what do you do to ensure that you have a uniform procedure?

Mr. BURKE. Let me see if I can give you some degree of comfort in terms of how we select the organizations for examination. As Howard mentioned, we do have specific areas, such as tax-exempt bonds, and lobbying activities and that cause us to look at the returns and then select those that are engaging in these activities.

We also look at compensation levels that are contained on the returns to lead us into questions and to decide whether we want to do audits.

In addition, and this is what makes, I think, exempt organizations unique and perhaps more difficult, is we have this vast universe of nonfiling organizations. Churches, for example, that do not have to file. Many of the media televangelists do not file tax returns because they classify themselves as a church. What we are faced with in selecting those returns or determining which of those organizations we will examine is looking to other sources such as newspaper reports or other data.

Mr. JEFFERSON. Is that an adequate way of getting after that problem?

Mr. BURKE. It is a very difficult process, Congressman, when you start to deal with an absence of even an information return.

One of the things we are doing to make this a better process, a more effective process in selecting the organizations for examination, is moving toward requiring the larger exempt organizations to

file electronically which will allow us to better analyze the returns and to be able to do a more effective job of selecting them for examination.

Mr. JEFFERSON. In a case where the IRS does not revoke an organization's tax-exempt status, what does it do? What happens?

Mr. BURKE. We have been employing, as the Commissioner indicated in her testimony, closing agreements to a greater extent. Because many times what we would like to do is instead of revoking the exempt status of the organization with the heavy adverse impact on the community, we would like the organization to continue operating and provide the services to the citizens of the community where they operate.

We will impose an appropriate tax sanction as part of the closing agreement, and force disengagement from the inurement or other activity which is providing unacceptable private benefit. In return we will continue to recognize exempt status so the community benefits can be provided.

Mr. JEFFERSON. When you look at the amounts that are paid to executives, for instance, do you look at it as some sort of ratio to the size of the outfit or are you simply looking at the total amounts of compensation as a signal to you there is a problem?

Mr. BURKE. There is no one approach to looking at the executive compensation packages, because you have so many different forms of compensation. You have it in the form of fringe benefits, such as interest-free loans.

It is a question of looking at all the available information, which includes what is on the returns plus whatever else you may have in terms of information from other sources. There is not one selection process.

If you will be patient with me for just about 1 more minute.

Mr. JEFFERSON. As long as the chairman is patient with me, I will be patient with you.

Mr. BURKE. I want to just amplify what we are doing with respect to our selection process and I mentioned earlier a couple of times the statistical sampling process that we are employing now. We brought a statistician on the staff.

We are segmenting exempt organizations for examination so we can provide back to the Congress, as well as for our own information and the public data as to the numbers of groups, the percentages of the groups that we examine, and the extent to which they are compliant with the tax laws.

It will allow us to do a few audits and still come up with compliance readings within those groups.

Mr. JEFFERSON. The Commissioner has testified that the Service has not ruled in advance on questions as to whether compensation is reasonable or whether an amount represents fair market value. It is on page 4 of the testimony.

If the Service does not rule in advance and does not look or examine after, how do organizations know if they are complying with the law?

Mr. SCHOENFELD. Well, we don't rule in advance. This becomes an issue upon examination, Mr. Jefferson. The question will arise when the revenue agent comes into the organization, does the

audit, looks at the organization and examines all of the issues relating to the compensation.

It is an examination issue when this problem is first addressed.

Mr. JEFFERSON. Is there some reason why advanced rulings cannot be made to organizations about the openness of compensation?

Mr. BURKE. Yes, there is some reason, and the reason is when you look at each organization, you find they have their own needs in what kind of executive leadership they want and that determines the kind of compensation levels they need to pay in order to get the talent they want.

To be able to sit in judgment as to the compensation levels before the organization even operates or before they even have a chance to determine what compensation they think they should be paying, would vest with the government or the IRS, a judgment I don't think we can reasonably make.

I really think the question of reasonableness of compensation is one that needs to be made not within the IRS but within the organizations that are determining what they need in executives.

Mr. JEFFERSON. I guess the idea was to try to stem some of the damage before it gets done and then worry about enforcement and then worry about the other.

In the transfer pricing area, as an example, the Service is advocating the use of advance pricing agreements. Can a similar approach be used in the tax-exempt area?

Ms. RICHARDSON. I will jump in here. I am not sure we have given a lot of thought to that. It has certainly been successful in the transfer pricing area. I am not exactly sure how we would work out something like that here, but if it is relating specifically to compensation, I think Mr. Burke pointed out it is very difficult without the benefit of hindsight and some information that evolves as you move along I think to make an advance judgment about what compensation is appropriate.

There are competitive factors, there are a number of factors that are really hard to judge. It may well be in Chicago the compensation you would pay an executive in a charity is very different than you would pay in Washington, D.C., or suburban Virginia or rural Virginia.

Mr. JEFFERSON. Is there some way—this is my last inquiry in this area—can you tell me how many instances or how many cases in the past year the Service has found compensation to be unreasonable upon the application of this review process?

Mr. BURKE. I can tell you that the issue has come up more than 100 times. I can tell you that many of those—

Mr. JEFFERSON. In the past year?

Mr. BURKE. Yes, sir. I can tell you that in many of those cases the issue is still pending because we are still looking at the aspects of the history of that individual in terms of their earning power. For example, their history of earnings and experience in the field.

It is a very complex area and it gives us a great deal of difficulty. Once we find the compensation excessive, we are then faced with the degree of substantiality to determine if revocation is appropriate.

Mr. JEFFERSON. This is an area that seems to most offend the giving public, if you will, and that is why I have asked all these questions about it.

Mr. Chairman, I have concluded.

Chairman PICKLE. Thank you, Mr. Jefferson.

Now, Commissioner, let me ask some fundamental questions, and I want you to give me some cases of abuses. You have given me four or five examples of revocation cases. I would ask you how many cases has IRS revoked an exemption in the last year?

Mr. BURKE. Approximately 30. We have been averaging between 25 and 30 revocations of 501(c)(3) public charities each year. It becomes much greater if you are going to go into all exempt organizations.

Chairman PICKLE. As I recall, the last time you appeared before a congressional committee the answer was about five and that was only 2 or 3 years ago.

Mr. BURKE. It was less than that.

Chairman PICKLE. Less than that. So at least you have increased from 5 to 30.

Mr. BURKE. But that was just with respect to hospitals. The question came up in connection with a hospital hearing.

Chairman PICKLE. Then I asked you the question how many revocations have you made with respect to 501(c)(3) regarding inurement.

Mr. BURKE. I believe most of the revocations, I don't have a precise figure, but most of them are a result of inurement issues.

Chairman PICKLE. How many is most?

Mr. BURKE. Over 20.

Ms. RICHARDSON. We can provide the exact information. We can provide that. We can provide you with the precise information for the record.

[The information follows:]

ANALYSIS OF THE ISSUES LEADING TO THE REVOCATIONS OF THE 60 IRC 501(c)(3) ORGANIZATIONS PUBLISHED IN THE INTERNAL REVENUE BULLETIN DURING 1991-92

Issue	1991	1992
Inurement	9	11
Failing to operate as a 501(c)(3)	8	8
Violation of IRC 6033(a)(1) (Refusal to file form 990)	8	1
Racial discrimination	1	6
Political activities	4	1
Organizations determined to be described in IRC 501(c)(9) rather than 501(c)(3)	2	0
Excessive fundraising expenses	1	0
Total	33	27

Chairman PICKLE. Just for the record, and I am not trying to make a point, except I guess I am, you have some 30,000 new organizations a year. How many did you disapprove or reject?

Mr. BURKE. We actually received, I believe, somewhere in the range of 53,000 or 54,000 applications and there were some 11,000 to 12,000 that were not approved. They either withdrew, or we issued denials, but approximately 30 percent of the applications are not approved.

Chairman PICKLE. Well, Mr. Burke, you are taking into consideration all those who didn't complete or withdrew or something. I am asking how many did you actually reject. My figure shows somewhere around 550 last year. Is that correct?

Mr. BURKE. I would have to tell you that we can consider the fact that we ask questions that the organization can answer and the organization then withdraws its application.

Chairman PICKLE. I know you want to get credit for those that withdraw or fade away, the fact of the matter is you reject about 500 out of 30,000.

I take some encouragement in the fact that the Commissioner and you have said we should have some kind of other sanctions.

Let me ask you, we put into law in 1987 a 5-percent excise tax with respect to lobbying activities. How many revocations have you made, or exemptions taken away, for lobbying activities since that time? How many times have you invoked the 5-percent excise tax, Mr. Schoenfeld?

Mr. SCHOENFELD. Since 1987 there are only a handful of cases, if that many. At least a couple of cases where we have invoked that, the excise tax was enacted in 1987. Those cases have just started to filter their way up through the audit stream and the appeals process within the Internal Revenue Service. Having said that, Mr. Pickle—

Chairman PICKLE. From 1987 to 1993 they are just beginning to filter, and you can't tell me whether you have had 5 or 10 for revocations lobbying?

Mr. SCHOENFELD. They were effective for tax years beginning in 1988. But the important thing about those provisions were that they were an intermediate sanction, which we think was an effective way to deal with the potential abuse.

Not only does it give us in the area of lobbying and political activity an alternative to revocation of exemption in an appropriate case, it provides for an abatement in appropriate cases as well.

So the fact we have not revoked an organization is not a true measure of the effectiveness of the statute or of the Service's application of the statute.

Chairman PICKLE. You are saying you have not invoked the 5-percent lobbying excise fee and the 5- and 10-percent fee means it is just a threat and if you don't straighten up, we are going to fine you, and that is all it is?

Mr. SCHOENFELD. That is true.

Chairman PICKLE. Then that leads me to say, if we have a 5-percent tax on the inurement, on the self-dealing, that all you would use it for is as a threat against an organization to get in line or else we are going to fine you.

Mr. SCHOENFELD. There is a very strong deterrent effect to that kind of sanction.

Chairman PICKLE. So we have the stark acceptance of the fact that all you do is use this as a threat, then?

Mr. SCHOENFELD. No.

Ms. RICHARDSON. I don't think that would be a fair characterization.

Chairman PICKLE. It is with respect to the fact that I suppose you have not hit a loud foul in this field. Yet, I ask myself, what good will it do to give you interim sanctions if you are not going to use them except maybe as a threat.

I think the only way you are going to straighten up this huge advance of tax-exempt organizations, of nonprofits that are going to get bigger than the government, is to take action. This business of examining it and massaging it and squirting a little foo-foo on it is not going to do it. You will have to do something about it rather than just study it to be ultra, ultra fair.

Now, that is my cold and honest opinion of it. That is a personal opinion.

Ms. RICHARDSON. I don't think anybody sitting at the table today disagrees with you. I think that we, across the board, not just in the exempt organization area want to step up our enforcement efforts. We are very concerned about making certain that the people who do comply can be comfortable knowing the people who don't comply are——

Chairman PICKLE. The vast majority of people do comply. Many of the people we talked to, 4 or 5 years ago objected to our inquiries, including the Independent Sector who didn't want to give us any information. They said that is in the field of their private business, not the Congress' business and they would not give us information. Now, I think they would like to see the abuses minimized and cut down to where legitimate tax-exempt organizations feel they are complying with the law and they are being accepted and appreciated for what they do.

To do that, though, we have to take action as long as we see these kinds of stories popping up. You are going to see them all over the country, because you cannot answer a lot of these questions. You only are theoretically analyzing it and saying there are some excesses in there.

Yes, out of 24 pages in the Inquirer you might pick out two or three things that are not factual, but I found it very factual.

Well, let me say this: I want to know from you, now, the IRS before you leave here, I want to know where the abuses are, Commissioner. What are the abuses you can tell me that are happening out there? I want to know where they are, what they are, and how you want us to help you. You give me these cases involving revocation, and I think there are four or five examples that have happened in the last 5 years in your testimony.

Now, I want you to get down to some facts. What are the abuses? Let us hear what they are.

Mr. BURKE. The abuses that we found in the examination program that we have conducted in exempt organizations really center on the issue of inurement. Most of them get into the question of to what extent assets or other funds within the exempt organizations are going to the benefit of the people who control them.

We have found in the larger organizations that there are questions of inurement, and we find ourselves spending a lot of time raising the issue, pursuing the issue, and then once we get through

and we establish at least to our satisfaction that there is a question of inurement or an issue of inurement, then we go through the process of granting the organization its appeal rights.

But the issues of then getting into revocation of the organization and getting into whether or not we have to spend additional time getting into what is the impact on the community in which the organization operates. All of these things take time, all of these things present major administrative difficulties to us and that is why we think that interim sanctions, when we find questions of inurement, would allow us to move much faster and be able to deal with the issues more effectively and efficiently.

Chairman PICKLE. Now, Mr. Burke, you have given me a general outline of procedures you use. We have spent 2 hours going through this very cautious, careful review. I am asking for examples of the abuses.

Do you have examples of particular organizations that you can give to me? What are the abuses exactly?

Mr. BURKE. The examples that we have in the written testimony here are examples that I can allude to or give you as illustrations of inurement.

Chairman PICKLE. Well, let me try to get at it this way. I have a question here in line with this. I am going to give you some examples of what my subcommittee has found out, and then I hope you can call and raise me and give me some examples instead of talking in generalities.

Our subcommittee reviewed 250 of the returns of the largest tax-exempt organizations and this is just a summation of a bit. Overall we reviewed the compensation of 2,000 top executives of these organizations and found that 1,711 were paid less than \$200,000; 170 were paid between \$200,000 and \$300,000; 64 were paid between \$300,000 and \$400,000; and 38 were paid more than \$400,000. Six of these were at hospitals, 24 at universities, 4 at private foundations and 4 were in other organizations.

There were 18 loans to top executives by the organizations; 10 were for more than \$200,000. These are just from the top 250 organizations.

Now, let me give you an example of some transactions involving taxable subsidiaries. A hospital has 23 related organizations on its form 990. Fourteen of these organizations are for profit. The hospital paid its taxable subsidiary \$4.7 million for diagnostic services. I won't mention the name, but this is a hospital.

Another medical center paid its taxable subsidiary \$6.5 million for construction. Does that sound a little bit questionable to you?

In the field of private inurement, I am not going to have you answer because we know what the answer is. Regarding private inurement, reasonable compensation, and self-dealing, in the area of loans, the president of a school received a salary of \$365,000 and a loan of \$1 million. The loan provided funds to purchase and to renovate his residence. That was \$500,000 in an instance, \$1 million to both purchase and renovate his residence. It is interest free until maturity and it expires in 50 years. The Lord has taken care of him for 50 years.

Now, that is a matter of record. Another case, a hospital has \$1.5 million in loans to officers, directors, and employees outstanding at

one time. That is in a hospital; \$1.5 million loans to its directors and the employees.

Another example, the director of surgery has a hospital loan of \$845,000 outstanding, which is secured by his home. Another hospital is lending funds to doctors so that the doctors can set up private practices. That is the free enterprise system, isn't it?

With respect to salaries, four trustees of an educational assistance charity are each paid almost \$700,000. I don't want to say this is just wrong, but it has to raise the question, when a charity is paying that much, what is reasonable compensation.

The head of another organization, of a public charity, is paid \$1 million a year; that is a college retirement fund.

The president of a university receives \$640,000 in 1 year in compensation and severance. That is close to home, right here, \$600,000.

A doctor is paid \$700,000 or \$900,000 by certain hospitals while there are other nonprofit hospitals paying the top doctors half of that amount.

Well, I will go on. The president of a retirement fund, which largely receives revenue deposited for retirement benefits and pays beneficiaries is receiving \$450,000 a year. There are outside consultants on contract for over \$700,000. We have a case where one university hired a lobbyist for \$600,000. They call them consultants, not lobbyists, but that is a matter of fact.

Regarding expenses, the CEO of a hospital received \$166,000 in expense payments. Regarding private inurement, a hospital used the engineering services of a firm of a board member. Regarding charitable purposes, a university spent \$600,000 in 1 year to hire a Washington lobbyist. Two other universities spent a total of \$650,000 for the same lobbyist. He hooked them twice, \$300,000 from one university \$350,000 from another.

One university had a surplus in revenue in 1 year of \$196 million, while total tuition payments were \$127 million. Let me repeat that, now that is pretty good. That is a good old Ivy League school. One university had a surplus in revenue in 1 year of \$196 million while total tuition payments were \$127 million. Everybody could come to school for free for a year and a half almost if they would just use some of their reserves.

A charity supporting the arts had income and assets rise by \$110 million in 1 year and only spent \$3 million in that year for charity. In the area of form 990 information, numerous form 990s provided to the subcommittee were missing pages and/or reference schedules that were not attached.

I have a feeling you have the same problem with 990s. They are not complete and you have to keep going back and going back to get the information.

One organization simply stated, "Information is available in the taxpayer's personnel file" instead of listing the amounts paid for expenses. That is a nice little round-away dodge, isn't it? A hospital's doctors are paid \$9 million through a professional service contract with a subsidiary organization so that form 990 did not show the names. However, the new 990 has a provision to address payments by related organizations.

Now, my staff picked these examples out. These are just from the top 250. You have nearly 1.2 million of these organizations. I don't expect you to be going back and auditing all these things, but when I ask you for examples, you talk in generalities about the procedures you use and you want to be careful.

I hear that and I don't disagree with you on it, but I think the public wants to know where are the abuses. To me, there is a serious question about each of these examples, I mentioned and yet I have a hard time pulling that information out of you so that we can share it.

I would say to you, Commissioner, I expect you to give us some examples of the abuses that are taking place and where they are taking place. Let's see if we cannot find an answer to them, because if we don't, this whole business will eat us up. I know that there is a lot of interest in this because the halls are full of people who are concerned about this little charity question.

While I want us all to be blessed, I want us to try to do something about it. I think this committee is resolved that we will do something this year in this field that will be worthwhile. We are going to try to do the right thing. We hope we can do it with your help.

Do you have any comment? I have some other individual questions but, Mr. Jefferson—

Mr. JEFFERSON. Are they responding to you, Mr. Chairman, I don't know. Before I ask a question, I think Mr. Burke is responding to you.

Mr. BURKE. I don't know that my giving any more examples would serve any purpose. You have covered so many that I would be reluctant even if I could to start to add to what you have given us.

I also have to dance around section 6103 and I think I would prefer to let your statements stand.

Chairman PICKLE. I didn't mention any names. I am inclined to and I may do it in some of these other hearings. Regarding section 6103, we will face that when we come to it.

Ms. RICHARDSON. I might note on pages 9 and 10 of our written statement, we did refer to some abusive situations with a little more specificity.

But as Mr. Burke said, we are constrained by 6103 and not in a position to give enough of an example that someone could identify who the taxpayer might be. But we do look forward to working with you.

Chairman PICKLE. I mentioned examples and I don't think I violated section 6103.

Ms. RICHARDSON. No, and we have some other examples in our written testimony as well. But we do look forward to working with you and your staff and the Treasury in coming up with some specifics and what we feel will be effective and appropriate sanctions.

Mr. JEFFERSON. Let me, Mr. Chairman, if I might—

Chairman PICKLE. Mr. Jefferson.

Mr. JEFFERSON. After you have conducted the examinations and assuming you have found some matters that you consider to be violative of the law in this area, how do the contributors know about it? How are results of these examinations reported publicly?

Mr. SCHOENFELD. The publication of the examination results in the case of a revocation comes about only in one way, Mr. Jefferson, and that is by delisting the organization, the public charity, from publication number 78.

This is the publication that lists all the organizations that are eligible to receive deductible contributions. Periodically, within the Internal Revenue bulletin, we list these organizations, we update it. We did it just a few weeks ago and there were seven such organizations that were listed there.

But all the public knows is that those organizations no longer are eligible for deductibility of contributions. The public has access to no other information unless the organization would choose to litigate the case with us in court, and then the litigation record would become publicly available.

Mr. BURKE. Can I just add something?

Mr. JEFFERSON. Go ahead.

Mr. BURKE. One of the things we are currently precluded from doing is disclosing adverse actions by the Service with respect to exempt organizations.

So, for example, if we revoked the exempt status of an organization because of inurement or some other reason, we should be able to, or we would like to be able to, communicate to the public what has happened, whether the imposition of the requirement is with the organization or with us, we should be able to get something out which explains why an adverse action was taken.

We think that would be beneficial to the public and it would be appropriate.

Mr. JEFFERSON. Do you think it would be appropriate only in the cases that involved revocation, or would it ever be appropriate in a case short of revocation?

Mr. BURKE. I think we should also look at the possibility if we were to have interim sanctions. They would also provide the opportunity for information to be disclosed to the public as to why the sanctions were imposed.

We have employed closing agreement techniques to get information before the public requiring the organization to publicize what took place, but, again, those are just a few—

Mr. JEFFERSON. As one member of the committee, I would certainly urge a recommendation in this area so that we might look at how we might better disclose the actions of, the adverse actions taken by the Service with respect to examinations.

Right now, as I have explained, there are preclusions that may not work in the best interest of the public at this point.

The Tax Code requires nonprofit groups to show anybody who requests an original application for tax-exempt status as well as the last 3 years of their form 990. The complaints are that many organizations don't comply with this requirement in the law, some leave information blank, and some refuse to provide access to the form or shift some of the organization's activities to its for-profit subsidiaries so that the information does not have to be publicly disclosed.

I want to know if this information strikes you as true. I don't know to what extent, but if you have run across this happening,

and if so, how much, how many cases, how many times, and how does the Service address this problem?

Mr. SCHOENFELD. I can't quantify that for you, Mr. Jefferson, but once is too many because the issue here is public accountability, and charitable organizations are supposed to account to the public through the disclosure of the IRS form 990.

So we are disappointed whenever we hear stories that organizations don't make the return fully available, and we are trying to make sure that other agencies do whatever they can do. When we hear complaints from the public that an organization is not fully complying, we want to get that return to the public and to make sure the information is complete and that it is accurate. We always look for ways to try to look for abuses in this area.

You just alluded to one where there has been a shifting of information off of the IRS form 990 into a subsidiary which is not open to the public. This was a problem that was brought to our attention last year and the problem we tried to address through amendments to the form that became available for 1992.

And beginning for tax year 1992, in the case of compensation of officers, directors and key employees, if the compensation by one of these employees, total compensation, is \$100,000 or more, and \$10,000 or more is provided by a related or affiliated organization, even if it is a taxable organization, that information still must be provided on the IRS form 990.

Because we have been concerned that taxable subsidiaries have been used as vehicles to avoid the disclosure rules of the form 990.

At the same time, we are looking to ways overall to improve the access to these returns, and one of the ways that Mr. Burke has mentioned before is that we are looking into electronic filing and we think that one of the effects of electronic filing will be to improve the understanding and the accessibility of the public to these public disclosure documents.

Mr. JEFFERSON. I guess in your last comment you tried to outline what in your estimation the Service can do to improve public access to this information. Did you exhaust the whole of your suggestions in that area?

Mr. SCHOENFELD. Well—

Mr. BURKE. No, it does not. The fact is that we do need to sit down and explore with the members of the subcommittee and their staff along with Treasury, much more sunshine so that the public is aware of what is going on.

Mr. JEFFERSON. Well, one last thing, Mr. Chairman. The new provision on the form 990 will ask for a schedule where related companies are also paying compensation. Next year, if three top executives are paid by one or more related organizations, as is the case at one hospital that may have been referred to by the chairman, will someone looking at form 990 be able to see the amounts listed and determine total compensation?

Mr. SCHOENFELD. Yes. If the total compensation is \$100,000 or more, then the return for tax year 1992, which for calendar year organizations was due to be filed May 15, that information would be available if the amount paid by the related organizations was \$10,000 or more.

Yes, Mr. Jefferson, a member of the public would be able to find out that information from the return.

Mr. JEFFERSON. I don't have any other questions, Mr. Chairman.

Chairman PICKLE. Well, thank you, Mr. Jefferson. I noted Mr. Kleczka has joined us. Do you have any questions of this panel?

Mr. KLECZKA. No questions, Mr. Chairman.

Chairman PICKLE. I want to ask a few additional questions. I know we have another panel after this, so I don't want to hold you, but Commissioner Richardson had testified the IRS examination routinely turns up circumstances where compensation is not properly reflected on the form 990.

You made, Mr. Schoenfeld, some reference to it a moment ago, or at least where it is not properly characterized as compensation by the organization.

Now, my question is how do organizations disguise payments made to insiders?

Mr. MCGOVERN. Mr. Chairman, what we have discovered in the past year is really the result of audit guidelines we issued with respect to our large corporations, hospitals and universities. We are looking in the taxable fringe area, such as luxury automobiles, chauffeurs, country club dues, maids, etc. These items provided to executives are generally taxable. In many instances, we are finding they are not being reported as compensation to the individual on forms W-2.

Chairman PICKLE. Now, Mr. McGovern, I hear you, what are you doing about it?

Mr. MCGOVERN. Well, there are two issues when you find that. One, you analyze the entire compensation package to determine whether it is reasonable. If it is not reasonable, exemption is in jeopardy. The second issue is an income tax issue. If taxable fringe benefits have not been reported as wages you require the organization to issue an amended form W-2 C and make the executive file an amended form 1040X.

Chairman PICKLE. My question is, are you doing that?

Mr. MCGOVERN. The answer is yes.

Chairman PICKLE. Have you corrected anything or caught anybody on that?

Mr. SCHOENFELD. Mr. Pickle.

Chairman PICKLE. Yes, Mr. Schoenfeld.

Mr. SCHOENFELD. That is exactly why the Service has established the coordinated examination program because this means that when the Service is doing the audit of a large public charity and that large public charity also has related individual returns, related taxable subsidiary returns, the agents doing that audit will pursue appropriate adjustments through all of those returns.

We are doing it today. We are following up on those cases today. We are asserting deficiencies as appropriate on the related taxable organizations today.

Chairman PICKLE. I don't want to cut you short, but I am glad to hear you are doing it today. Did you start this last month, or last November, or how long has this been going on?

You say you are looking at it. I don't know that you have actually found cases where there is inurement that is disguised. I am as-

suming that you are. I just want to know, has this been going on for 2 or 3 years. Are you accounting for the "salary, the income?"

Ms. RICHARDSON. We began the coordinated exam program in the beginning of fiscal year 1992.

Chairman PICKLE. Well, at least you are under way on it.

Ms. RICHARDSON. So it wasn't last week. We are certainly under way.

Chairman PICKLE. I don't mean to infer you just started.

Mr. MCGOVERN. We also have a few pilot programs in the country. One notable one is in the Pittsburgh district where we have taken a look at contracts between physicians and the hospitals. We have analyzed the contracts to see whether the physicians have reported on their individual income tax returns taxable fringe benefits that are part of their compensation package.

Chairman PICKLE. I don't think you, or we the committee, should be "hard on it," but if there is \$1 million coming in from another source, it is income. I don't think you can turn your back and just let it go because that would ruin the whole system if you did that.

All I want to know is, are you doing it?

Ms. RICHARDSON. We are looking at it now and we intend to continue looking at it.

Chairman PICKLE. I have some questions and maybe you can answer this yes or no. I don't know who will be the spokesman here, but you are all eager.

With regard to possible legislative openings, what are you considering generally? Are you considering the area of more sunshine for the public? Mr. Burke you said yes, didn't you?

Mr. BURKE. Yes, I did.

Chairman PICKLE. Well, you don't have to give an example. You are for that, though, that is the main thing.

Mr. BURKE. Very much so.

Chairman PICKLE. Would it help IRS if the reason why an exempt organization's status was revoked by IRS was made public?

Mr. BURKE. We would want to work with the subcommittee along those lines.

Chairman PICKLE. Well, let's see.

Mr. KLECZKA. Mr. Chairman.

Mr. BURKE. I think I testified that that would be the desire.

Ms. RICHARDSON. We have all testified we would like to see that happen. We think it would be beneficial.

Chairman PICKLE. If you are waiting for our leadership, then the answer is yes.

Would it help IRS if there are limitations on the amount of compensation paid to charity executives? Specifically, would it be helpful if charities had to get IRS approval to pay compensation in excess of the salary paid to the President of the United States?

Mr. BURKE. I don't—

Ms. RICHARDSON. I was going to say, I don't think that would be helpful to us. I think that is a very difficult issue. I think we have found it was difficult in the for-profit community and I think we would find it equally difficult for the not-for-profit.

Chairman PICKLE. You don't want your President to get as much as some of these CEO's are getting?

Ms. RICHARDSON. I am sure he would like to, but I don't know about that.

Chairman PICKLE. Would it help IRS if it was required that a charity disclose whether it has paid any additional tax as a result of being sanctioned by the IRS for private inurement, political action lobbying, or unrelated business?

Ms. RICHARDSON. We think that type of a disclosure could be very helpful.

Chairman PICKLE. All right, I think I would agree with you. If they fail to obey the law, it ought to be put on the form.

Ms. RICHARDSON. We agree.

Chairman PICKLE. All right. Would it help IRS if there were greater access to form 990?

Ms. RICHARDSON. Yes. I think—we feel it would help the public.

Chairman PICKLE. I agree. Would it help IRS if there were limits on the duration of tax-exempt status?

Mr. BURKE. I think we would like to look into that. That is a tough one to answer yes or no.

Chairman PICKLE. It would be for us, too. But they get on the books and they are there forever.

Mr. BURKE. It is a serious problem.

Chairman PICKLE. They will last longer than the stars I say to myself. Well, could we find a better way? I don't know what the answer is, but if there is a better way, you and I would agree we should do something about it if we can.

Mr. BURKE. The answer to that is yes.

Chairman PICKLE. Would it help IRS if there were authority to require a charity to reapply with IRS in order to continue its tax-exempt status?

Ms. RICHARDSON. I think that may fall in the category of the last question. We would need to think about it. It would certainly increase the paperwork burden, and I am not sure we want to do that in this day and age.

Chairman PICKLE. I think a better way is to say we are going to see.

Ms. RICHARDSON. Certainly something to think about.

Chairman PICKLE. I don't know whether we would want to fool with it either, but that happens in many cases in the legislative world. You have to come back and start over again rather than just let them last forever.

Do you have any legislative or administrative recommendations to help donors?

Mr. BURKE. We have some thoughts, but I think they really ought to be crystalized with the subcommittee and our colleagues at Treasury so that what we have is a totally consistent approach to resolving some of the problems that the chairman has brought up.

Chairman PICKLE. Well, let me see. I have some other questions to ask.

Mr. Kleczka, if you want to join in on this, I certainly would welcome you.

Mr. KLECZKA. Chairman is doing fine. When I feel a need and am so moved, I will join in.

Chairman PICKLE. Some of these are questions I was going to ask you with respect to the for-profit tax provisions, inurement and reasonable compensation, the prohibition against excessive lobbying, prohibition against political activities, and taxation of unrelated business income.

All of those have been pretty well touched on except the last one, the UBIT question, and we are not primarily aimed at that in this hearing.

I don't think that I have any other questions that I would want to ask you at this particular time.

I think I will simply say to you that this is the first in a series of hearings we are going to hold until we get, we think, factual data on the record. We will be looking to you for recommendations or suggestions or comments on various things that we have proposed or any recommendations you have for us. On the surface, we must do a better job of it. When these kinds of articles are written just about one city and one area, I can envision this popping up all over the United States. The public then is going to be disillusioned about what is happening. We are in a catch-22. We want charities to function because they do a better job than government, but at the same time we ought not let private inurement or self-dealing or abuses get into the system. Somehow we have to stop the vast, the rapid, growth of these programs.

I get the opinion sometimes that Congress ought to say we are going to freeze all 501(c)s for the next 2 years. Do you hear me? We may do something like that if this thing doesn't get under better control. We may have to set up a special task force to take extreme cases so we won't cause great hardship. If we can freeze Federal salaries, we can freeze applications for 501(c)s.

If it takes something like that, I could support it. We are trying to find a better way. I ask you to give us your cooperation. I am convinced you are going to do that, and I think we have a better understanding than we have had before. I think this committee can take the primary lead in bringing about corrections. I hope we can do it.

Mr. KLECZKA. Before the panel finishes, let me turn to the unrelated business income issue. Where are we on compliance with the unrelated business income?

I think we all hear from commercial organizations in our district, trying to compete with charities that are involved in some of these for-profit activities; and it irks them, knowing that for the most part the charitable organization pays no Federal income taxes, State, property taxes, which is a big issue in Wisconsin. Are we finding compliance from organizations involved in for-profit activities?

Mr. SCHOENFELD. That is a good question.

Mr. KLECZKA. That is why I waited until last. I wanted the best question last.

Mr. SCHOENFELD. IRS just completed a study of compliance in this area, and I think it would be appropriate for us to furnish the complete study for the record. The headline is that compliance in the UBIT area needs improvement.

Mr. KLECZKA. The study has been completed?

Mr. SCHOENFELD. Yes.

Mr. KLECZKA. And what did you do?

Mr. SCHOENFELD. We went through forms 990-T by categories of—

Mr. KLECZKA. What type of sample versus the total filings in that area?

Mr. SCHOENFELD. Without the study, I am afraid to give you exactly what the sample was. But it was a study that was done with the assistance of our statistical staff within the Service, and they reached broad conclusions about compliance as regards public charities, private foundations, section 501(c)(4) welfare organizations and other categories of organizations.

Mr. KLECZKA. When will that be completed?

Mr. SCHOENFELD. It is completed.

Ms. RICHARDSON. We will provide it for the record.

[The information follows:]

Form 990-T Compliance Study

The study attempted to measure the levels of voluntary compliance among the various types of exempt organizations with respect to their unrelated business income. However, any conclusions or observations drawn from the results of that study should be qualified for several reasons.

First, the study included only those exempt organizations that actually file Forms 990-T - the part of the E.O. universe which could be expected to be the most compliant. No valid conclusions can be drawn from the study with respect to the much larger part of the E.O. universe which did not file a Form 990-T.

Second, the voluntary compliance level for 501(c)(3) organizations (non-private foundations) is of questionable value for any enforcement or educational program because of the great disparity of organizations covered by that section which includes exemption for churches, schools, membership organizations and general community fund raising organizations.

Third, the much higher relative voluntary compliance level for private foundations may not actually reflect voluntary compliance so much as it reflects the environment in which private foundations operate. They engage in very little activity that could give rise to taxable unrelated business income. Section 4943 virtually prevents them from engaging in active unrelated trade or business. Further, situations which may give rise to taxable unrelated income are governed by provisions that are fairly clear and rather well known and understood in the E.O. community. For example, unrelated debt-financed income under section 514.

Unrelated business income tax (UBIT) continues to be a priority item for the Service. UBIT was identified as a significant examination issue and area of concern in the Exempt Organization 1993 Workplan and will be accorded such status in the 1994 Workplan. In addition, UBIT continues to be a frequent topic in our annual continuing professional education text. This text is not only used by the Service to educate its agents and specialists, but it is also used by the E.O. community, where it is highly regarded, as a reference manual.

The Service has continued its efforts to bring the E.O. community into compliance with existing tax laws. In years subsequent to the study, the Service has improved its methods of collecting information and its use of the information collected. Under our Compliance 2000 strategy, statistical sampling techniques are employed to produce more reliable data at a lower cost than previous TCMP studies. Statistical sampling allows the Service to identify non-compliant sectors more accurately thereby promoting more efficient use of limited enforcement resources.

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Form 990-T Compliance

by Chih-Chin Ho

This article presents the recently revised compliance rate estimates for exempt organizations filing Form 990-T, Exempt Organization Business Income Tax Return. The rates are based on the Taxpayer Compliance Measurement Program (TCMP) data for unrelated business income tax (UBIT). Empirical findings suggest that certain exempt organizations with large reported UBIT might be more compliant than those with smaller reported UBIT.

Background

Briefly stated, unrelated business income (UBI) is defined in tax law as income from a trade or business, regularly carried on by an otherwise tax exempt organization, that is not substantially related to the organization's exempt purpose. The unrelated business income tax (UBIT) was designed by Congress to place unrelated business activities of exempt organizations on an equal footing with similar activities carried out by taxable entities. Form 990-T, Exempt Organization Business Income Tax Return, is required to be filed by exempt organizations having gross UBI of \$1,000 or more.

In more recent years, there has been a major focus on the movement of exempt organizations into commercial activities. Of particular interest is the potential for unfair competition between non-profit and for-profit businesses that provide similar services. As a result, there has been intensified interest in the Federal tax treatment of the income-producing activities of exempt organizations and their Form 990-T compliance.

Form 990-T filers include organizations exempt from tax under Internal Revenue Code (IRC) 501(c). The largest subsection group (c[3]) consists of public and private foundations for charitable, religious, educational, and scientific purposes. They are followed by civic associations (c[4]), labor unions (c[5]), business leagues (c[6]), social clubs (c[7]), fraternal societies (c[8]), and other exempt organizations (c[1]-c[2], c[9]-c[25]).

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Compliance measures in the UBIT area have been developed using data from the IRS Taxpayer Compliance Measurement Program (TCMP). In the TCMP surveys, a random sample of tax returns are selected for extensive, line-by-line examination. The survey results can be used to estimate overall compliance and compliance for each line item of the return.

"Voluntary compliance level" (VCL) and "compliance rate for filers" (CRF) were used to measure Form 990-T compliance. The VCL is the ratio of tax reported on the returns to the sum of tax reported plus any tax understatements. The CRF is the ratio of tax reported on the returns to estimated true tax liabilities.

Note that the CRF accounts for both underpaid and overpaid taxes, since all tax changes are included in the calculation. In contrast, only understatements of tax enter into the calculation of VCL--any overstatements are considered as no change and their magnitude is set to zero. Since each measure has its own relative merits, this article presents both without making a judgement on them.

Methodology

TCMP Phase VI, Cycle 3 examined exempt organizations filing Form 990-T for calendar year 1986 and fiscal years ending through November 1987. Churches and pension plans were not included for various administrative reasons. The survey sample was stratified by IRC 501(c) subsection and by the amount of UBI. After analyzing the data, it turned out that UBI was only distantly related to UBIT within subsection, causing the sample to underestimate total tax on filed returns. In addition, since the breaking point chosen to select high dollar returns was too high, the sample underrepresented the largest exempt organizations. The weaknesses in the TCMP data resulted in a highly skewed distribution of total UBIT returns. Thus, we were concerned that the compliance rate estimates based on the TCMP data would be biased and their respective confidence intervals would be unreliable.¹

We had to revise the data because of these reasons. Three statistical methods were used to rectify the data problems and revise the compliance rate estimates:

- post-stratification calibration to correct the underestimation of total UBIT returns;

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- regression-modeling imputation to adjust the underrepresentation of the largest exempt organizations;
- bootstrap replication to reduce the volatility and asymmetry inherent from a skewed distribution and to generate more reliable confidence intervals.

Regression stabilized the compliance rate estimates and bootstrapping obtained narrower confidence intervals. Therefore, the resulting bootstrap distributions appeared normally distributed for most IRC 501 (c) subsections and the revised estimates were more reliable than their counterparts derived from the original TCMP data. The model structure and methodological issues are discussed in greater detail in a previous publication by the author.³

Empirical Findings

The VCL and CRF estimates for each IRC 501 (c) subsection are shown in Table 1 and Table 2. The compliance rate estimates under "Raw TCMP" are based on the original TCMP data and those under "Revised TCMP" are based on the revised TCMP data.

Table 1
VCL Estimates of Exempt Organizations Filing Form 990-T

Type of Organization 501 (c) Subsection	Raw TCMP VCL	Revised TCMP VCL	Revised TCMP CI
Public Charities	45%	56%	44-68%
Private Foundations	94	96	79-100
Civic Associations	52	58	39-86
Labor Unions	61	75	66-84
Business Leagues	52	66	57-75
Social Clubs	51	53	46-60
Fraternal Societies	48	64	44-84
Other Organizations	96	95	92-97

CI = 95 percent confidence interval

Business leagues and labor unions with large reported UBIT might be more compliant than those with smaller reported UBIT

The revised VCL and CRF estimates are significantly higher for business leagues and labor unions than their respective raw estimates. In both instances, the raw VCLs and CRFs do not even fall within their respective 95 percent confidence interval based on the revised estimates. Fur-

thermore, the regression results indicate that the revised CRF increases as the UBIT reported on returns increases for labor unions and business leagues.³

Statistically, this means that the exempt organizations of labor unions and business leagues with the largest reported UBIT were underrepresented in the original TCMP sample, and once the enhancement procedures were used and the biases were removed, the revised estimates reflected much higher compliance levels. From a compliance perspective, this finding would suggest that business leagues and labor unions with large reported UBIT might be more compliant than those with smaller reported UBIT.

Table 2
CRF Estimates of Exempt Organizations Filing Form 990-T

Type of Organization 501 (c) Subsection	Raw TCMP CRF	Revised TCMP CRF	Revised TCMP CI
Public Charities	46%	59%	46-74%
Private Foundations	94	97	79-100
Civic Associations	57	66	42-108
Labor Unions	66	81	70-95
Business Leagues	59	75	62-84
Social Clubs	52	60	52-68
Fraternal Societies	68	97	50-198
Other Organizations	101	99	95-104

CI = 95 percent confidence interval

Private foundations were more compliant than their public counterparts

The revised VCL and CRF estimates show a relatively low level of compliance for public charities, civic associations, and social clubs in comparison to other organizations considered. The revised rates also show a high level of compliance for private foundations and other exempt organizations.⁴ Both labor unions and business leagues had moderate levels of compliance.

Certain fraternal societies had UBIT overpayment

Fraternal societies had a low revised VCL (64 percent) and a high revised CRF (97 percent). They also had a wide confidence interval with a high upper bound for the CRF (50-198 percent), while they maintained a moderate and symmetric confidence interval for the VCL (44-88 percent). Statistically, this means that a substantial UBIT overpayment

was reflected in the CRF but not in the VCL, because any tax overpayment is considered as no tax change in the formation of the VCL.

From a compliance perspective, this finding would suggest that certain UBIT rules may be too difficult and confusing for fraternal societies to comply with. As a consequence, some organizations end up with a substantial UBIT overpayment.

Data Limitations

The above findings are insightful, but come with some important qualifiers. First, the current TCMP data covered only Form 990-T filers. It did not identify exempt organizations that should have filed a Form 990-T but did not do so. To assess the nonfiler portion of Form 990-T compliance would require us to rely on earlier TCMP data and Exempt Organization (EO) operational data.⁵ Thus, our data for Form 990-T filing compliance (nonfilers) are weaker even than the data for Form 990-T reporting compliance (filers).

Secondly, the current TCMP data also excluded churches and pension plans that filed Forms 990-T. In addition, the absence of churches in the EO operational data on delinquent Forms 990-T further diminishes our ability to assess Form 990-T compliance for churches.⁶

Finally, the previously described enhancement procedures to adjust compliance rates are difficult, time-consuming, and expensive. To examine the compliance rates for other important line items in the UBIT area would require too much work for the subject to justify. For example, to revise compliance rates for just one line item, such as reporting of gross receipts, it would require almost as much effort as we have expended to revise the VCL estimates.

Conclusion

The empirical findings suggest that certain types of exempt organizations with large reported UBIT might be more compliant than those with smaller reported UBIT. In this regard, IRS initiatives other than direct enforcement might be useful to foster compliance in this area. For example, the IRS could provide improved education and more simplified tax forms and instructions through existing taxpayer service programs which could enhance these exempt organizations' understanding in Form 990-T filing.

Since every exempt organization with gross UBI of \$1,000 or more is required to file a UBIT return, it appears that the primary enforcement focus should be placed on the EO universe of Form 990 filers to identify potential Form 990-T nonfilers.⁷ Also, those types of organizations with

high potential for nonfiling of UBIT returns should be reviewed and targeted with nonenforcement approaches to improving compliance.

Endnotes

¹A confidence interval refers to a boundary established by a particular sample estimation in which the true value would be no higher than the upper bound and no lower than the lower bound with a prescribed level of confidence. A 95 percent confidence interval means that in 95 cases out of 100, the true value that would have been obtained from the population would be within the boundary established by the sample estimation.

²W. Wang and C. Ho, "Bootstrapping Post-Stratification And Regression Estimates from A Highly Skewed Distribution," in the 1991 Proceedings of the American Statistical Association, pp. 608-613.

³The regression slopes of these subsections were less than one, which indicates that after reaching a certain threshold, corrected UBIT increases less proportionally than reported UBIT.

⁴The extremely high VCL and CRF for this group mainly reflect the compliance level of its largest subsection, voluntary employee beneficiary associations (c[9]), which represents about 75% reported UBIT of the group. Due to the resource constraint, the subsection c[9] cases were not separated from other exempt organizations for analysis.

⁵The TCMP examinations of Forms 990 filed for the 1979-1983 period recorded delinquent Forms 990-T. However, this data is old and may no longer be representative of current filing noncompliance. For the past few years, under the Exempt Organization Information Gathering Program, EO examiners have been completing checksheets for all delinquent Forms 990-T secured during operational examinations. However, these checksheets only represent the selected cases and cannot be considered as a random sample. As a result, these data would not permit valid statistical inferences to be drawn on potential nonfiling exempt organizations.

⁶Although we do not have statistical evidence to ascertain the significance of the nonreporting of unrelated business income by churches, we do consider it as an important missing link in the UBIT area.

⁷Generally, except for churches, organizations exempt from tax under IRC 501 (c) are required to file Form 990, Return of Organization Exempt From Income Tax.

Mr. KLECZKA. We would like to look at that. Last, let me broach an area which has been talked about by the chairman, and I am assuming other members before I arrived, the whole question of reasonable compensation. Do you have any guidance for the Congress or this subcommittee on setting some type of reasonable limits?

If a charity is paying its executive director a million dollars a year and its executive board hundreds of thousands of dollars, giving interest-free loans out, one has to question whether or not that is a charitable organization using the full thrust of their collected donations to help whatever the goal of the organization is.

Mr. BURKE. Present law, Congressman, is that the same rules apply with respect to determining the reasonableness of compensation for exempt organizations as well as taxable corporations. We actually look at the same regulations under section 162 and we make the same determinations.

It is something that really could not be offered in the way of a solution or a remedy at this point, but it is something that we would be more than pleased to work on with the subcommittee and Treasury to see what we can do in dealing with compensation levels provided by exempt organizations.

Mr. KLECZKA. The reconciliation bill does deal with the compensation levels of certain executives in the taxable corporate area. Do you not think that that can be expanded to also include the 990s, the 501(c)s?

Ms. RICHARDSON. I think the whole area is one that we would really like to explore with this committee, short of just setting a limit and saying nothing can be above that.

Mr. KLECZKA. No, you can pay above that, but at that point, it becomes taxable because we feel that is above and beyond—

Ms. RICHARDSON. All the compensation paid to an executive is reportable income, or should be, for that executive. It is the organization that is nontaxable. But the executive owes tax on the income. So you don't have the same situation you would have in a—

Mr. KLECZKA. But the funds were raised from individuals thinking they were helping a worthy cause, and if there is more availability from the tax filing to know these things, perhaps the public would reassess where they gave their tax dollars. But without that information being readily available, these things go; on, and I think we are well aware that the individual pays taxes, but the money was raised through a different guise versus paying salaries.

Ms. RICHARDSON. In the for-profit area, though, you can deny a deduction for the compensation, which you can't do here; so you would have to think of another sanction such as denial of compensation in excess of a certain amount.

Mr. KLECZKA. How many exemptions have been revoked in the last 3 years?

Mr. BURKE. Approximately 90 (c)(3) organizations. If you take all of them in terms of the entire gamut of 501(c) organizations, it would be somewhere in excess of a thousand.

Mr. KLECZKA. The major cause for revocation is—

Mr. BURKE. Inurement seems to be the most prevalent issue.

Mr. KLECZKA. Thank you very much. Thank you, Mr. Chairman.

Chairman PICKLE. Thank you. I thank you for your testimony and for your help and your cooperation, and we will be having other hearings soon to follow through.

Ms. RICHARDSON. Thank you, Mr. Chairman.

Chairman PICKLE. Keep Treasury advised.

Ms. RICHARDSON. We will. We look forward to working with you and with the Treasury in coming up with some rules that are effective and workable.

Chairman PICKLE. The next panel consists of the National Charities Information Bureau, the Council of Better Business Bureaus, and the Evangelical Council for Financial Accountability. Kenneth L. Albrecht, Bennett M. Weiner, and Thomas McCabe accompanied by Mr. Reimer.

Our panel now consists of the National Charities Information Bureau, Inc., Kenneth L. Albrecht.

Next we will hear from Bennett M. Weiner, the Council of Better Business Bureaus, the CBBB. And then we will have Thomas McCabe, chairman of the Evangelical Council for Financial Accountability.

We will hear first from Mr. Albrecht.

I will ask you all to condense your testimony, if you care to in the interest of time, but I don't want you to not give your whole statement if you so wish.

[Witnesses sworn.]

Chairman PICKLE. The record will reflect that you said I do. The first witness will be Kenneth L. Albrecht.

STATEMENT OF KENNETH L. ALBRECHT, PRESIDENT, NATIONAL CHARITIES INFORMATION BUREAU, INC.

Mr. ALBRECHT. My name is Kenneth Albrecht. I am president of the National Charities Information Bureau. Our mission is to promote informed giving and as a central part of our work, NCIB undertakes the monitoring and evaluation of more than 350 national charities, a population representing better than 10 percent of contributions to nonreligious organizations in 1992, and including some of the largest national organizations.

We use nine basic standards in our evaluations dealing with governance and program of an organization, its solicitations, its use of funds and public accountability and reporting. Our standards reflect NCIB's 75 years of experience in the field of charitable evaluation, including in the recent past, a 2-year Standards Review Project.

In this effort we enlisted an advisory panel of prominent representatives of the philanthropic community to ensure that our standards would continue to reflect the best in current thinking about charitable practices and public accountability. The results of our evaluations are made available in the form of NCIB reports and we have sent some of those reports to the committee staff.

These reports are provided to the public on request, and up to three are provided free of charge. There are at this time approximately 250 reports available.

In addition, we publish a Wise Giving Guide on a quarterly basis that lists all the organizations we review and indicates each organization's rating against our nine standards. It is distributed to all

our contributors, and upon request, single copies are provided without charge.

The identification of organizations for a NCIB review is driven largely but not solely by evidence of contributor interest such as the number of inquiries we receive.

Sending information to us is voluntary. We have no authority to compel an organization to provide data to us.

Materials and information used by us in our reviews include a disclosure form, the organization's most recent annual report, its audited financial statements and IRS form 990, samples of fund-raising materials and any other descriptive information about programs or other materials that the organization may wish to send us.

In our analyses, we make frequent reference to an organization's form 990 as corroboration, correction or just simple amplification of the information presented in the group's annual report and audited financial statements.

An evaluation with respect to each of the standards is approached separately; yet it is also true that the standards are substantially interrelated and that questions raised in one area of evaluation often find their explanation or exacerbation elsewhere in another standard.

It is important to note that approximately 77 percent of the charities that we have reviewed, and for which we have full evaluations, meet all of our standards.

We are committed to the belief that an informed contributor is a wise contributor. Our first and foremost interest, therefore, concerns the issues and practices of charitable accountability to the contributing and general public. What we most importantly promote and champion is the ability of any contributor or potential contributor to obtain all the information necessary to make a personally satisfying charitable gift decision.

We firmly believe that the key to ensuring improved performance in charities, performance above and beyond any legislative requirements, is educating the public. Anything that this subcommittee can do to increase the level of public awareness of acceptable and desirable parameters for charitable behavior and accountability would be efforts magnificently spent.

On the one hand, there is a pervasive and misplaced public perception that the favorable treatment accorded under the current Tax Code reflects natural rights rather than earned privileges. This misperception is vociferously promoted by individuals and organizations whose activities could not well sustain much contributor scrutiny. It is a misperception which can and will only be corrected by an equally vigorous effort that champions full accountability.

On the other hand, the same public seems to be beginning to believe that some charities are getting away with murder and that no one is policing their activities at all.

Some balance between these two contradictory states of public perception must be attained.

Our experience indicates that there are at least four major areas in which issues of public trust come to the forefront.

One of these is governance. There is only limited information about an organization's governing board which is routinely available to contributors.

A second relates to the mass solicitations that are made on behalf of nonprofits whether by mail or on the telephone. Concerns arise both as to their number and to their content.

The third area of concern involves industry-wide accounting practices. Current accounting guidelines, the interpretations and applications of those guidelines and the acceptance of responsibility for the final reporting results are all problematic issues in today's non-profit world.

Finally, the fourth is the increasing blending of for-profit motives with nonprofit mandates. At times one has to wonder whether what is beneficial to commerce isn't taking precedence over what is beneficial to conscience.

As the staff head of an organization like NCIB, I believe strongly in self-regulation within the sector. That is to be expected.

The well-being of charities is based on public trust and faith in their ability and willingness to be held to standards of behavior that are above and beyond any laws which a government may pass.

Over 65 years ago, England's Lord Justice of Appeal, John Fletcher Moulton, used a phrase that succinctly and evocatively characterizes this ideal philanthropic trait, "obedience to the unenforceable."

The record over many years is that the public's trust in charities has been well placed. The credibility and integrity of the people and the organizations that make up the independent sector has been, in the vast majority of cases, outstanding.

However, we cannot place our faith only in the naive belief and the good faith of every individual and organization that claims to be charitably inclined. Thus, some level of regulation also is required, especially in view of the growth in the size and complexity of the charitable sector and the increasing number of concerns that have arisen.

That regulation, however, needs to be directed at the major issues, and should not resort to reliance on comprehensive, detailed and stringent legislation.

The common interest we all have, the committee, the IRS, the charities who have many of their people here today, organizations here at this table who are involved in self-regulatory efforts as well as those whose responsibilities are in a more formal legislative arena, is to assure that the public trust is maintained and that it continues to be deserved.

Thank you, Mr. Chairman.

[The prepared statement follows:]

Written Testimony to the
Subcommittee on Oversight
of the Committee on Ways and Means
of the
U. S. House of Representatives
presented by
Kenneth L. Albrecht, President
National Charities Information Bureau
June 15, 1993

This testimony addresses, as indicated below,

Issues identified by the Subcommittee:

1. The information currently available on independently audited financial statements that is not currently available to the public on the Form 990 or other record.

The Financial Accounting Standards Board (FASB) has been reviewing, and has announced it will issue within the next few weeks, a Statement establishing the accounting profession's standard minimums for information to be included in a not-for-profit's audited financial statements. Until now there has been no such industry-wide standardization. However, these standard elements of financial disclosure are truly basic minimums, and, as is now the case, what and how much additional information will be included will vary substantially.

Currently many audited financial statements often contain substantial additional information compared to that on the Form 990. However, such information is not generally or necessarily relevant to the concerns of the average contributor.

On the other hand, many of the disclosures required by the Form 990 are not included in an organization's audited financial statements. In addition, the standardization in accounting and reporting procedures required by, if not complied with, in completing the 990 are far more stringent than in audited financial statements.

It is apparent when reviewing a broad range of audited financial statements against a range of Form 990s that the latter format is far more obviously designed with the interests and welfare of contributors in mind than is the former. This is not necessarily surprising: state regulators are the servants of the people and auditors are individuals paid by reporting organizations.

2. What needs to be done to improve the information on and accuracy of the Form 990.

The principal problems with effective contributor use of Form 990s lie with the accuracy of the information provided, not in what information is required or in the ways that information is presented. The more funds made available to strongly encourage or enforce the accurate completion of 990s, the better off the contributing public will be. As a beginning, if state budget administrative funds were available, regulators could routinely bounce 990s with a significant number of errors or omissions back to the reporting organizations with a fine. That might wake some people up!

3. Whether all organizations should be required to make an audited financial statement available to the public in addition to the Form 990 or in lieu of the Form.

NCIB Standard #8 requires that an organization make its audited financial statements available to the public. This requirement is

accompanied by another one of equal importance: the organization must also make available a narrative description of its activities (usually in the form of an annual report) which is directly comparable to the categories presented in the audit. In essence, NCIB requires the audit along with something that will make the audit at least minimally comprehensible to the lay reader.

We believe that all organizations should make their audited financial statements available as a matter of course, if nothing else as an indication of a recognition that this is intrinsically public information anyway. We are not, however, convinced that the audit alone will be of much general usefulness to the layperson. And, most emphatically, we do not think that it should be allowed as a substitute for the Form 990, which has been explicitly designed with the contributors' needs and uses in mind.

4. How donors can learn whether organizations have been the subject of a recent State or Federal Government action and why is it important that donors be aware.

It is important that donors be able to be aware of every significant element in a nonprofit's history and current practices which might have an impact on that person's evaluation of the organization's integrity, credibility and overall trustworthiness. Whether the government might properly mandate a required disclosure of specific information which would almost certainly have an effect on contributions decisions is another matter. This is especially problematic when such information is necessarily somewhat negative. Recent experiences with required disclosures of fund-raising expenses and the like have made us very leery of the legal defensibility of such requirements, no matter how sensible they may be.

5. Which Standards are most frequently violated by the organizations that you have reviewed.

Based on the citations in the June 1993 Wise Giving Guide, the standards (or standards subsections) most often not met are:

# of occurrences	Standard #	Description of Requirement [the organization must...]
17	1h	[have] policy guidelines to avoid material conflicts of interest involving board or staff
16	6a	spend at least 60% of annual expenses for program activities
16	6b	insure that fund-raising expenses, in relation to fund-raising results, are reasonable over time
15	1j	[have] a policy promoting pluralism and diversity within the organization's board, staff and constituencies
13	1c	[have] an individual attendance policy [for board members]
12	1e	[have] in-person, face-to-face meetings, at least twice a year, evenly spaced, with a majority of voting members in attendance at each meeting

# of occurrences	Standard #	Description of Requirement [the organization must...]
11	1g	[have] no more than one paid staff person [as a member of the board], usually the chief staff officer, who shall not chair the board or serve as treasurer

6. (Includes #15) How should the Government and the public address the activities of the charitable organizations which you reviewed that were not in full compliance with your Standards. Discuss the actions donors should take with regard to organizations on NCIB's list of organizations providing insufficient data.

NCIB believes that the information required by our Standards should rather routinely be made available to the general public. When an organization chooses not to provide such information to us for analysis and evaluation, but does send some information to a potential contributor (usually in the context of a fund-raising appeal), we believe that the contributor should be doubly careful in assessing that information. In other words, "caveat donor."

The NCIB position is different with respect to organizations that do not meet one or more NCIB Standards. We, of course, believe that they should meet all our standards. But on each and every issue there is may be some good reason somewhere for someone to nonetheless either 1) honestly disagree with the NCIB Standard or its application or 2) have other reasons for continuing to give that outweigh the lack of organizational compliance with the Standard(s).

Appropriate government responses in both cases are 1) efforts to improve public understanding of charitable activities and public reporting requirements; 2) funds for more vigorous enforcement of those requirements for providing of public information that are already in the law.

8. Whether IRS should more closely monitor organizations to determine if they continue to adhere to their goals.

Organizational goals are often, and allowably, so generally phrased that it would be awkward to even claim that those goals were not being pursued, and next to impossible to prove that they were not. Nor should the IRS be in the position of having to evaluate the philosophical "charitableness" of any given set of mission statements.

However, the IRS should have the funds available to more closely monitor whether or not an organization's pattern of actual expenses is even remotely consonant with anything besides the enrichment of particular individuals.

9. To what extent are charities all following the same rules in reporting information and allocating expenditures on the Form 990, and whether these rules provide the public with sufficient information, especially with regard to fund-raising costs.

Patterns and methodologies in fund-raising expense reporting exhibit the greatest professionally allowable variety that exists within Generally Accepted Accounting Principles (GAAP). For all the recent efforts of the Financial Accounting Standards Board, and the forthcoming efforts of the American Institute of Certified Public Accountants (AICPA), this is unlikely to change soon.

Meanwhile, such standardization as there is is in the relatively restrictive instructions for completing Form 990 rather than in the audited financial statements.

10. How many organizations have met, have not met, or provided insufficient information related to, your Standards in 1990, 1991, and 1992.

Numbers in parentheses in the following chart indicate "new" or "revised" reports issued that year and are included in each category total.

ID stands for "insufficient data." In 1992 NCIB began to prepare reports on some such agencies from publicly available information. Here we have grouped all such agencies (whether we prepare some form of report or not) under the one category, however, since we thought the Subcommittee's interest was principally in an organization's unwillingness to provide information we requested.

	Meets	Not meets	ID	Total
1990	237(54)	47(20)	62(7)	346(81)
1991	189(34)*	50(21)	60(7)	299(62)*
1992	194(80)	54(33)	61(15)	309(128)

*Decrease in reports available reflects general housecleaning and withdrawal of older reports for updating

11. Whether principals of exempt organizations are getting lucrative consulting contracts while the publicly discloseable information is not showing these large payments and what can be done to make donors aware of these contracts.

Certainly some are. We do not have any general recommendations as to how the public is to be made aware of such arrangements because detection of them is usually deliberately made difficult. Typically, such arrangements are not the result of innocent misunderstandings of public accountability and the expectations of a public's trust. Rather, they are deliberate attempts to defraud and deceive, and they have not been so structured as to encourage easy observation.

12. What organizations in the most recent "Wise Giving Guide" violated three or more of your Standards.

Based on the citations in the June 1993 Wise Giving Guide, organizations that have not met three or more standards (or standards subsections) are:

Cedars Home for Children Foundation	1cghj,4,6c,7c
Childhelp USA	1adg,6d,7ac
Children's Aid International	1chi,6abd
Conservation International Foundation	1ghj,7a
Council for Basic Education	1hj,7
Cousteau Society	1achij,6b,7,9
Diabetes Trust Fund	1cehj,4,6ab,7c
Earth Island Institute	1gi,8ab
Ethics and Public Policy Center	1cehi,7c
Fund for an Open Society	1gi,6b,9
International Cancer Alliance (formerly Cancer Research Council)	1g,6ab,7a
Keep America Beautiful	1cdhj,7c
National Anti-Vivisection Society	1cfhj
National Council of Negro Women	1gh,9
National Emergency Medicine Assn.	1g,4,6ab,7c
National Humane Education Society	1eg,6ab
Natl. League of Families of American Prisoners and Missing in S.E. Asia (Natl. League of POW/MIA Families)	1cdhj
Paralyzed Veterans of America	1cghj,6ab
Save-the-Redwoods League	1chj,6c

Southern Poverty Law Center
Southwest Indian Foundation

1cehj, 4, 6abc, 7c
1ach, 6ab

13. What actions are being taken by the States that should also be taken at the Federal level to ensure better compliance and public accountability.

We would recommend that such actions include efforts to educate the general and contributing public as to its privileges and rights with respect to charitable accountability; and the ways in which the public can 1) enforce, and 2) make efficient, productive and satisfying use of the information made available through such accountability in making their individual contributions (or noncontributions) decisions.

14. Why organizations failed to comply with your request for information.

Few take the opportunity to tell us. One reason cited is the organization's (real or merely convenient) unwillingness to file with both NCIB and the Philanthropic Advisory Service of the CBBB. (It should be noted that PAS gets approximately the same number of demurrers in reverse). In several instances the correspondence records in our files allow for no doubt that the organization was or is aware that it is not in compliance with one or more NCIB Standards. Some organizations may simply have no intention of providing anyone on the outside information about anything. We have no way of knowing.

15. (see #6 above)

NCIB comments on outline of proposed legislation:

1. A five percent excise tax, applicable to organizations and individuals for acts of inurement, private benefit, self-dealing, and unreasonable compensation.

We are not at all convinced of the practicability of the assessment of any such tax. Parameters for its application would be a nightmare to design and establish. In addition, those organizations and individuals most flagrantly in violation of the spirit behind the imposition of such an assessment would probably willingly pay it in return for the continuation of their access to nonprofit postal rates for their direct mail campaigns.

2. A reasonable compensation limitation which would apply unless the organization's payment of a larger amount was pre-approved by IRS.

We do not agree.

3. Provide IRS with authority to grant tax-exemption for limited periods of time, such as three, five or ten years.

This is an interesting concept, and one we would like to see further explored. Implementation of any such tiered structure on what would have to be an across-the-board basis, however, would require substantial additional IRS funds.

4. Require that the Form 990 provide a section in which an organization would need to report payment of additional taxes for self-dealing, prohibited political activity, excessive lobbying, and unreported unrelated business income.

We would agree.

5. Provide for additional public access to the Form 990.

We would agree that the Form 990 should be more readily available, and that organizations should be required to provide a copy upon written request and payment of a reasonable fee for the costs involved, including organizational staff time.

However, we would again recommend that there be, as well, significantly greater efforts applied to the assiduous and comprehensive monitoring and enforcement of complete and accurate 990 organizational filings.

Chairman PICKLE. I thank you.

I have some questions, but—I notice you commented in your testimony that you submitted to us, that you had serious questions about the possibility of a 5-percent excise tax applicable to these organizations. Are you for or against it, or do you just raise questions about it?

Mr. ALBRECHT. We are not convinced of the practicality of the assessment of such a tax and the parameters of the application would be a nightmare, we think, to design and establish. So we have some very serious reservations about a 5-percent excise tax.

Chairman PICKLE. What would you propose then? Any kind of a sanction? Revocation?

Mr. ALBRECHT. I think there should be interim sanctions. I believe some of the discussion in previous testimony referred to things of that nature. I think that makes sense.

I believe that also the 990 should be more available and more easily available to those who wish to see it. I think disclosure and letting the sun shine on those forms is important and should be encouraged and extended.

I think there could be additional questions on the 990, and you have named one. I think that would make good sense as well.

Chairman PICKLE. Thank you.

Mr. Weiner.

STATEMENT OF BENNETT M. WEINER, VICE PRESIDENT, PHILANTHROPIC ADVISORY SERVICE, COUNCIL OF BETTER BUSINESS BUREAUS, INC.

Mr. WEINER. Thank you, Mr. Chairman, members of the subcommittee. My name is Bennett M. Weiner and I am vice president and director of the Philanthropic Advisory Service of the Council of Better Business Bureaus. I am pleased to provide comments about the accountability of charities and about how we serve as a source for information on national charitable organizations.

First, let me start by saying that the universe of charities we report on is not all 501(c)(3) organizations. We concentrate on publicly soliciting national charities and for the most part universities are not included and only a handful of hospitals are involved in those types of solicitations.

The Council of Better Business Bureaus is a nonprofit business membership organization, tax exempt under section 501(c)(6) of the Internal Revenue Code. We are supported by national advertisers, advertising agencies and other consumer product and service companies.

Our mission on behalf of these supporters is to promote ethical business practices through self-regulation. The Council Philanthropic Advisory Service develops information on national charities and evaluates them in relation to a set of 22 voluntary Standards for Charitable Solicitations.

We receive inquiries about charities for the most part from the general public. Inquiries on local or regional charities are referred to one of the local Better Business Bureaus nationwide.

The reports on charities and other materials we produce are not intended to comment on the worthiness of any particular organiza-

tion or cause. They are intended to help donors make more informed giving decisions.

We request a variety of documents to complete our reviews, such as annual reports, financial statements, budgets, articles of incorporation, board rosters, et cetera. These are materials that, for the most part, the charities should already have on file.

If we are aware of a local, State or other government action taken against a national charity, we will request a complete copy of the complaint and disposition of the case and this information would also be summarized in our report on the organization.

On average, about 90 percent of the organizations contacted by PAS provide requested information and materials. For the 10 percent that do not provide information, our experience has been that this lack of cooperation raises serious concerns with potential contributors.

The charities' materials that are provided are reviewed in relation to the 22 voluntary standards we have, which cover five specific areas of activity: public accountability, the use of funds, solicitations and informational materials, fundraising practices and governance.

One recurring theme within the guidelines is the significance of a charity's public appeals. Eight standards, over one third of the 22 guidelines, refer to the contents of the organization's solicitation materials.

For most donors, the appeal is the only contact they will have with the charity. Our charity reports are very short, about 2 pages in length.

They summarize the information the charity has provided to us and indicate whether or not the organization meets our voluntary guidelines. One of the most well-known publications is "Give, But Give Wisely" and it lists approximately 300 charities that are the subject of the greatest number of inquiries and specifies whether or not they met our standards, and that comes out on a bimonthly basis.

Of those charities that provide information, 23 percent, one out of four, do not meet one or more of the 22 voluntary standards that we have. There are no patterns that emerge regarding the types of charities for which noncompliances are found. They include charities of all ages, sizes and purposes.

However, the most frequently cited noncompliance finding, about 22 percent of them, involve the four specific expense percentage guidelines that we have, and in some cases, a single charity may not meet more than one of these percentage tests. One of these percentage guidelines calls for an organization to spend at least 50 percent of total income from all sources on program service activities.

Another guideline calls for organizations to have fundraising costs not in excess of 35 percent of total related contributions. These type of expenditure guidelines are no longer within the purview of State government regulators because of several Supreme Court decisions in the past decade.

As a result, this has put more of a burden on donors to sort out those charities that approach them for support. The voluntary standard that we have, with the highest number of charities failing

to meet, is the one that calls for soliciting organizations' financial statements to include adequate information to serve as a basis for informed decisions.

Twenty-three of the most asked about national charities fail to meet this guideline currently. These observations are intriguing and perhaps disturbing in view of the fact charity finance is the most asked—about issue for inquirers who contact our office. The subcommittee specifically asked us to address compensation issues, and you should be congratulated for raising the issue and for demonstrating, by your example, the important relationship between management expenses and donor trust and expectations.

However, we urge great caution on this issue before profound legislation such as has been suggested is enacted. I say that because the data that we compile on national charities, at least for the ones that we review, does not suggest widespread abuse in this area.

Last year, we sent out a special survey to 203 of the most asked about national charities that solicit the general public. A strong 90 percent of them, about 183 charities responded and provided information on the amount of 1991 CEO compensation and other CEO benefits.

The average total CEO compensation for this group was \$105,000, and the data also showed that more than half, 56 percent, paid their CEO's less than \$100,000. More than 89 percent of them were paid less than \$150,000, and only nine, less than 5 percent paid their CEO's more than \$250,000.

As every employer knows, the amount of compensation must necessarily be related to the market; what are the demands of the job and who is available to do it well. An examination of the top nine charities in the mentioned data base for 1991 in terms of CEO compensation, provides some food for thought.

All nine CEOs managed large paid staffs, ranging from 206 employees to 8,000. The average number of employees for this group of nine was 2,100.

All nine CEO's managed substantial amounts of money and oversaw a significant volume of program services. The 1991 total combined income for these nine charities ranged from \$48 to \$668 million, and expenditure for program services ranged from \$47 to \$632 million.

On average, the nine charities spent over \$146 million on their program service expenses. All nine charities in this largest group devoted the bulk of their 1991 expenditures for program services.

The lowest proportion going to programs was 67 percent, the highest, 96 percent, and the average was about 82. Not only did these nine generally show substantial spending on programs compared to nonprogram expenses, all spent a modest percentage of management costs, ranging from less than half a percent to 19 percent.

We are in the middle of distributing an updated survey on CEO compensation to essentially the same national charities. Some 143 responses to date show that 1992 compensation totals are similar to last year's and early returns show an average for this group of about \$116,000, about a 10-percent increase over the average for the previous year of \$105,000.

What do we conclude from this? We just don't think the data shows widespread abuse of the sort that would justify legislative proposals that would fundamentally alter the relationship of the private sector, in this case, charities, to the IRS. A fundamental change, in our view, would occur if prior approval requirements for compensation were established or preset compensation limits promulgated.

Might there be occasional abuses? Of course, and unless more evidence of abuse is discovered, however, I think these are best handled through case-by-case inquiry and investigation by the IRS.

What then is our concern? We are mostly concerned that Congress not inadvertently take steps that would reduce the accountability of charity boards that would implicitly free these boards of the involvement they need on charity services, personnel and management to ensure accountability to donors.

How do we approach these accountability issues? In terms of accountability, the charity's buck does indeed stop with the board of directors. The board has the fiduciary or stewardship responsibility for the charity's finances.

A board that is not involved and committed can expose the charity to all sorts of potential accountability problems. We have seen some recurring problems for charities reviewed by our office involving the standard calling for an active governing body that meets with reasonable frequency and attendance. Our standard calls for the governing body of the organization to meet at least three times annually. Another standard calls for an independent governing body whose directly or indirectly compensated board members comprise no more than 20 percent of the total voting membership.

Boards should not be overly influenced by paid staff members or others who are not financially disinterested. The age of letterhead directors is long past. More than ever before, charity board members are recognizing the importance of carrying out their oversight functions.

The Council's Standards for Charitable Solicitations go above and beyond what is required by Federal, State or local government regulators. In some cases, such as charity expenses, governments are limited as to how they can regulate charities, and monitoring organizations such as PAS help fill this existing gap.

There are other factors that point to a significant role for voluntary guidelines. Even the most finely crafted piece of legislation can become pointless if there is inadequate government staff to enforce the new provisions. State attorney general offices and even the IRS can only go so far with existing resources.

The problem has been compounded I think in recent years by budget cutbacks that have taken place at the State level.

As far as the IRS 990 form is concerned, it can be a helpful source of financial information for contributors. It is becoming an increasingly significant public disclosure document and, in most cases, for example, it is the only place to find information on compensation as far as charity staff is concerned.

Now, with regard to the accountability issues being addressed at today's hearing, we would like to make the following final points: first, in our view, disclosure of helpful information is one of the best ways to encourage and foster a fair and open solicitations mar-

ketplace. Donors should have better access to basic information about charities that solicit their support.

Second, IRS regulations require charities to make a copy of their 990 forms available for public inspection at their offices but they are not required to send out copies in the mail or to provide inquirers with photocopies. If an inquirer contacts the IRS about these documents, it can sometimes take months before this information is received.

Now if charities were required to mail copies of their IRS 990 form for an agreed upon printing and mailing fee, this would enable donors to more quickly and easily obtain these documents.

Third, the issue of charity staff compensation is a subjective one and it would be difficult to regulate in view of the many different factors that would need to be considered. More importantly, some research has shown this is not as problematic an area as described in some recent accounts.

Of course, we agree that abuses should be investigated by the Service. However, perhaps the real issue is public access to compensation information, which in part may be partially resolved through better public access to 990 forms.

Fourth, another recommendation is to try to encourage active oversight by the charity's board. One way to help ensure this would be to require the chair of the charity's board to sign off on the IRS 990 form, perhaps in addition to the comptroller or officer that helps prepare the document. Currently, there is no requirement that a board member sign the 990 form document.

Fifth, the data shows that most organizations, in terms of our voluntary guidelines, do meet our standards and are cooperative with our requests for information. However, from what we have seen, the extent of the problems do not justify committee proposals that would fundamentally alter the relationship of the private sector, in this case charities, to the IRS.

Thank you for the opportunity to explain how we assist the public, and also provide our views on various accountability issues.

[The prepared statement and attachments follow:]

TESTIMONY OF BENNETT M. WEINER
VICE PRESIDENT, PHILANTHROPIC ADVISORY SERVICE
COUNCIL OF BETTER BUSINESS BUREAUS, INC.

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

WASHINGTON, D.C. JUNE 15, 1993

Mr. Chairman, and members of the Subcommittee, my name is Bennett M. Weiner and I am Vice President and Director of the Philanthropic Advisory Service at the Council of Better Business Bureaus. I am pleased to provide comments about the accountability of charities and about how we serve as a source for information on national charitable organizations.

Donors today are faced with difficult contribution decisions. Competition for the donated dollar has increased dramatically over the past decade and is likely to continue. Between 1987 and 1989 for every charity that closed, three new ones opened. It is estimated that in 1991 more than 516,000 organizations were tax-exempt as charities under section 501(c)(3) of the Internal Revenue Code. In addition to this, there were also 350,000 churches, temples and religious institutions in 1991 that are not required to file for charitable tax-exempt status.

This competition, along with a succession of various charity scandals and controversies, has fostered intense concern on the part of the donating public over the accountability of charitable organizations. Many individuals have been prompted to seek information before acting on requests for time and money. As a voluntary, nongovernmental organization, the Council of Better Business Bureaus makes this information available to donors through its Philanthropic Advisory Service, known as PAS.

Council of Better Business Bureaus, Inc.

The Council of Better Business Bureaus (CBBB) is a nonprofit business-membership organization tax exempt under section 501(c)(6) of the Internal Revenue Code. We are supported by national advertisers, advertising agencies and other consumer product and service companies. Our mission on behalf of these supporters is to promote ethical business practices through self-regulation. The Council is the national office of the Better Business Bureau system, which consists of over 160 local BBBs and branches and over 240,000 member businesses across the nation.

In addition to the Philanthropic Advisory Service, other CBBB programs include a self-regulatory mechanism to foster truth and accuracy in advertising, a mediation/arbitration service for resolving consumer-business disputes, consumer information publications and voluntary industry guidelines for the advertising and selling of products and services.

Inquiries as a Gauge for Action

CBBB's Philanthropic Advisory Service (PAS) develops information on national charitable organizations and evaluates these charities

in relation to the 22 voluntary CBBB Standards for Charitable Solicitations. PAS receives inquiries about charities from the general public, businesses, corporate contribution executives, foundations and others. Inquiries on local or regional charities are referred to the local Better Business Bureau serving that area. Overall, soliciting organizations are the subject of over 180,000 inquiries in the BBB system each year and rank among the top ten categories of public inquiry activity nationwide.

The volume of inquiries we receive determine which charities we will evaluate and report on. In 1992, charities involved with health care (such as health research and health education) generated the largest share (36%) of inquiries followed by international relief (15%), human services, such as counseling, crisis care, etc. (11%), veterans groups (9%), animal and wildlife groups (8%), environment (4%) and other (17%).

Developing Factual Information

The reports on charities and other materials we produce are intended to help donors make more informed giving decisions, not to comment on the "worthiness" of any organization or cause. PAS does not "approve," "register," or "endorse" charities. We maintain factual information and provide impartial reports about whether the subject charity meets our voluntary guidelines. We encourage donors to use all available information, including our reports, IRS 990 Forms, and materials from the charities, and to make independent decisions about their contributions.

In producing reports on national charities, PAS requests various current materials from national charitable organizations, including, but not limited to, annual reports, audited financial statements, fund-raising materials, contracts with outside fund raising companies, board rosters, budgets, articles of incorporation and bylaws. Almost all of the requested materials consist of items the charity already has or should have available.

If we are aware of a local, state or other government action taken against a national charity, we will request a complete copy of the complaint and disposition of the case. This information is summarized in our reports on the charity. Unless the action has been the subject of media attention or is somehow referenced in the charity's audit report, potential contributors are unlikely to be aware of it.

Nondisclosure

On average, about 90% of the organizations contacted by PAS provide requested information and materials. For the 10% that do not provide information, our experience has been that this lack of cooperation raises concerns with potential contributors.

While "nondisclosure" organizations do not generally explain their reason for not providing information, some groups claim that their government filings are sufficient to ensure accountability. On occasion, a religious organization may cite its reluctance to send materials to a secular monitoring group. In other cases, we suspect that the charity may be reluctant to provide information knowing that they would likely not meet our voluntary guidelines.

CBBB Standards for Charitable Solicitations

A charity's materials are reviewed in relation to the 22 voluntary CBBB Standards for Charitable Solicitations. These guidelines cover five areas of charity activity: (a) public accountability, (b) the use of funds, (c) solicitations and informational materials, (d) fund raising practices, and (e) governance. (Copies of the complete text of the standards were delivered with this testimony.) The standards were developed in consultation with

charities, fund raisers, corporate contribution executives, the legal and accounting professions, government regulatory agencies, local Better Business Bureaus and others.

One recurring theme within the CBBB guidelines is the significance of the charity's public appeals. Eight standards, over one-third of the 22 CBBB guidelines, refer to the contents of the organization's solicitation materials. For most donors, the appeal is the only contact they will have with the charity. This is all the more reason that we emphasize the accuracy and completeness of the charity's appeal within our standards.

Our charity reports are "user friendly" and generally are no longer than two pages in length. Each summarizes the programs, governance, finances, and fund raising efforts of the charity along with a section that indicates if the charity meets or does not meet the CBBB Standards.

Our most well-known publication is our bimonthly "Give But Give Wisely®" list, which includes the names of roughly 300 of the most-asked-about national charities and specifies whether or not the organizations meet the CBBB Standards.

Among other materials, we produce an annual consumer handbook on charitable giving, our "Annual Charity Index," which includes consumer advice on giving along with brief program and financial summaries of over 200 of the most-asked-about national groups.

Most Frequently Cited Noncompliance Findings

Of those charities that provide information, roughly one out of four (about 23%) do not meet one or more of the 22 voluntary CBBB Standards. There are no patterns that emerge regarding the types of charities for which noncompliance findings are found. They include charities of all ages, sizes and purposes. These findings change over time as charity practices change and as charities make specific efforts to address concerns that we bring to their attention.

About 75% of the PAS noncompliance findings involve guidelines in either the public accountability or use of funds sections of the CBBB Standards.

The most frequently cited noncompliance findings (22% of them) involve the four specific expense percentage guidelines. In some cases, a single charity may not meet more than one of these percentage tests. Our current edition of "Give But Give Wisely" includes six such instances of multiple noncompliances involving expenditure issues.

These CBBB Standards call for soliciting organizations:

1. to spend at least 50% of total income from all sources on program service activities,
2. to spend at least 50% of public contributions on the programs mentioned in appeals,
3. to have fund raising costs not in excess of 35% of total related contributions, and
4. to have total fund raising costs plus administrative costs not in excess of 50% of total income.

These type of expenditure guidelines are no longer within the purview of state government regulators. The Subcommittee is probably aware that in three U.S. Supreme Court cases during the 1980s, the Court struck down as unconstitutional, the state and local government use of percentage expense limitations to regulate charities. This has put more of a burden on donors to sort out

those charities that approach them for support.

The CBBB Standard that the highest number of charities failed to meet calls for soliciting organizations' financial statements to include adequate information to serve as a basis for informed decisions. Twenty-three (23) of the most-asked-about national charities do not meet this guideline. There are a number of different reasons why a charity is found not to have met this standard. The most likely cause is that the schedule of expenses within the charity's audit report is not detailed enough to clearly determine how the charity spent its funds.

These observations are intriguing and perhaps disturbing in view of the fact that charity finance is the most asked about issue for inquirers who contact PAS. Donors want to know how their contributed dollars are being spent.

Charity Salaries

The Subcommittee has specifically asked us to address compensation issues. You are to be congratulated for raising this issue and for demonstrating by your example the important relationship between compensation and management expenses and donor trust and expectations.

However, we urge great caution on this issue before profound legislation such as has been suggested is enacted.

The data we compiled on national charities does not suggest widespread abuse in this area. Last year we sent out a special survey to 203 of the most-asked-about national charities. A strong 90% (183 charities) responded and provided information on the amount of 1991 CEO compensation and other CEO benefits. The 10 percent that did not respond did not fall into any particular category. The average total CEO compensation for the 183 charities that provided information was \$105,370. The data also showed that:

- More than half (56%) paid their CEO's less than \$100,000.
- More than 89% of them paid less than \$150,000.
- Only nine (less than 5%) paid their CEOs more than \$250,000.

As every employer knows, the amount of compensation must necessarily be related to the market -- what are the demands of the job and who is available to do it well?

As examination of the top nine (9) charities in the mentioned data base for 1991 in terms of CEO compensation provide some food for thought -

- All nine CEOs managed large paid staffs ranging from 206 employees to 8,000. The average number of employees was 2,100.
- All nine CEOs managed substantial amounts of money and oversaw a significant volume of program services. 1991 total combined income for these nine charities ranged from \$48 million to \$668 million, and expenditures for program services ranged from \$47 million to \$632 million. On average, the nine charities spent over \$146 million on their program service activities.
- All nine charities devoted the bulk of their 1991 expenditures for program services -- the lowest proportion going to programs was 67%, the highest 96%, and the average was about 82%. Not only did these nine generally show substantial spending on programs compared to non-program expenses, all spent a modest percentage of

management costs ranging from less than 1/2 % to 19%, with the average at about 7.7% devoted to management expenses.

We are in the middle of distributing an updated survey on CEO compensation to essentially the same national charities. The 143 responses to date show that 1992 compensation totals are similar to last year's. The early returns show an average for this group of about \$116,000. This represents about a 10% increase from the previous period.

What do we conclude from this? We just don't think the data shows widespread abuse of the sort that would justify legislative proposals that would fundamentally alter the relationship of the private sector, in this case charities, to the IRS. A fundamental change would occur if prior approval requirements for compensation were established or if pre-set compensation limits were promulgated.

Might there be occasional abuses? Of course. Unless more evidence of abuse is discovered, however, these are best handled through case by case inquiry and investigation by the IRS.

What, then, is our concern? We are mostly concerned that Congress not, inadvertently, take steps that would reduce the accountability of charity boards; that would implicitly free these boards of the actual involvement they need on charity services, personnel and management to ensure accountability to donors. The boards are the guardians of the public interest here. Inserting the government between the boards and the CEO on the question of compensation relieves a board of the obligations it must undertake to evaluate performance, qualifications and the competitive market.

How do we approach these accountability issues?

In terms of accountability, the charity's buck does indeed stop with the board of directors. The board has the fiduciary or stewardship responsibility for the charity's finances. Among other things, it is responsible for oversight of the executive leadership and setting policies for the overall operation of the charity.

A board that is not involved and committed can expose the charity to all sorts of potential accountability problems. Some recurring problems for charities that are reviewed by PAS involve the CBBB standard calling for an active governing board that meets with reasonable frequency and attendance. Our guidelines call for at three meetings of the governing body annually with at least half of the members in attendance on average. Six percent of the most-asked-about national charities do not meet this standard.

CBBB Standards also call for an independent governing body whose directly or indirectly compensated board members comprise no more than 20% of the voting membership. Boards should not be overly influenced by paid staff members or others who are not financially disinterested. This helps to establish the objectivity of board decisions and to ensure that they are made in the best interests of the charity. About five percent of the most-asked-about national charities currently do not meet this guideline.

The age of "letterhead" directors is long past. More than ever before, charity board members are recognizing the importance of carrying out their oversight functions.

Relationship with Government Agencies

The CBBB Standards for Charitable Solicitations go above and beyond what is required by federal, state or local government regulators. In some cases, such as "charity expenses," governments are limited as to how they can regulate charities. Monitoring organizations, such as PAS, help fill this existing gap.

We fully admit, however, there also are limits to our ability to identify problems. We do not have subpoena power. We rely on the voluntary cooperation of the charities on which we report. However, some charities have criticized us for requesting too much information. PAS' questionnaire form for charities identifies 27 points of needed information including up to 17 possible enclosures. And, in recent months, we have begun to ask more questions and request other materials to complete our reviews.

More importantly, self-regulation places emphasis on the most influential monitor of any charity: the board of directors which has the power and authority to implement change within the organization.

There are other factors that point to the significant role for voluntary guidelines. Even the most finely crafted piece of legislation can become pointless if there is inadequate government staff to enforce the new provisions. State attorney general offices and even the IRS can only go so far with existing resources. This problem has been compounded in recent years by budget cutbacks that have taken place at the state level.

IRS 990 Form

The IRS 990 Form can serve as a helpful source of financial information for contributors. It is becoming an increasingly significant public disclosure document. In most cases it is the only source that includes compensation information on the five highest paid charity executives making \$30,000 or more. It can also provide useful information about related party transactions, and the identify of and amounts paid for professional services such as fund raising companies.

In recent years, the collaborative efforts by representatives from the IRS, the National Association of Attorneys General (NAAG), the National Association of State Charity Officials (NASCO), Baruch College in New York City, and the private sector have made strides in making the 990 Form useful for both federal and state government agencies. This has been a successful effort which should be encouraged to continue.

The general problem with the IRS 990 is that it is not taken seriously enough by the nonprofit sector. For example, a 1988 General Accounting Office Study showed that about half of Form 990 returns were lacking one or more supporting schedules required by the filing instructions. In other cases, such as with smaller organizations, there have been accuracy problems with the figures presented. For some organizations, the board never asks to see the 990 Form.

Another problem is that there are some distinct differences between the IRS 990 Form and audited financial statements that result in difficulties for preparers and users of these documents. The specific object category expense line items (for example, printing, postage, etc.) that appear in the 990 Form differ from many presentations in audit reports. This can cause problems in completing the 990 Form since nonprofit accountants will set up their accounts differently from what is requested by the IRS document.

In addition, charity audit reports will generally contain a more detailed breakdown for program service expenses than will appear in the IRS 990 Form. Part II, Column B, of the 990 Form includes one column for program service expenses. An audit report will generally include multiple program expense columns in those cases where the charity has more than one major program.

The audit report also differs from the IRS 990 in terms of preparation. In an audit report, an outside certified public

accountant will report on whether the financial statements were prepared in accordance with generally accepted accounting principles (GAAP) and audited in accordance with generally accepted auditing standards (GAAS).

Another important point is that organizations with revenues below \$25,000 are not required to provide financial data to the IRS. Reportedly, over 70% of the organizations that are tax-exempt under section 501(c)(3) of the Internal Revenue Code fall under this minimum revenue amount.

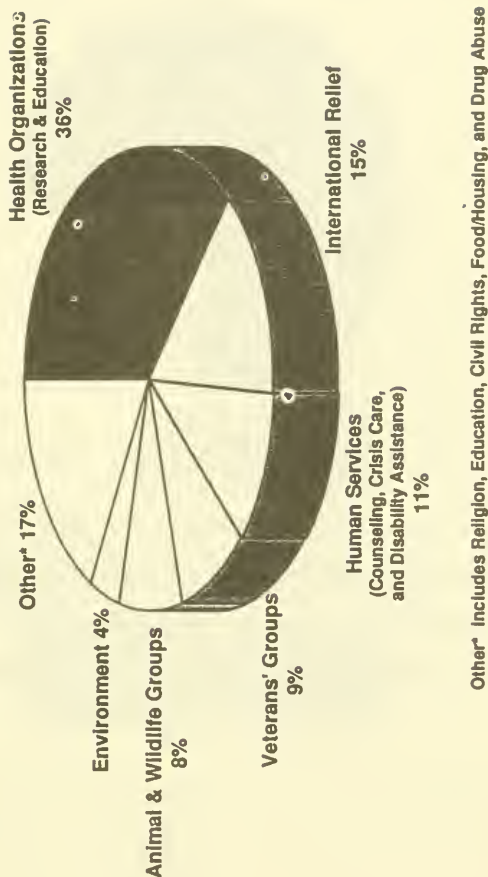
Conclusions

With regard to the accountability issues being addressed at today's hearing, we would like to make the following final points:

1. In our view, the disclosure of helpful information is one of the best ways to encourage and foster a fair and open solicitations marketplace. Donors should have better access to basic information about charities that solicit their support.
2. Current IRS regulations require charities to make a copy of their 990 Forms available for public inspection at their offices but they are not required to send out copies in the mail or to provide inquirers with photocopies. If an inquirer contacts the IRS for these documents, it can sometimes take months before this information is received. If charities were required to mail copies of their IRS 990 Form for an agreed upon printing and mail fee, this would enable donors to more quickly and easily obtain these documents.
3. The issue of charity staff compensation is a subjective one. It would be difficult to regulate in view of many different factors that would need to be considered. More importantly, research shows that this is not as problematic an area as described in some recent accounts. Of course, we agree that abuses should be investigated by the Service. However, perhaps the real issue here is public access to compensation information which, in part, may be partially resolved through better public access to 990 Forms.
4. Another recommendation is to try to encourage active oversight by the charity's board. One way to help ensure this would be to require the chair of the charity's board to sign off on the IRS 990 Form in addition to the controller or officer who helps prepare the document. Currently, there is no requirement that a board member sign this document.
5. The data shows that most organizations meet our standards and are cooperative with our requests for information. Of course, abuses should be investigated by the appropriate government agencies. However, from what we have seen, the extent of the problems do not justify Committee proposals that would fundamentally alter the relationship of the private sector, in this case charities, to the IRS.

Thank you for the opportunity to explain how we assist the public with information on charitable organizations and our views on various accountability questions.

The Most-Asked-About Charities in 1992



Source: Philanthropic Advisory Service, Council of Better Business Bureaus, Arlington, VA. Better Business Bureaus nationwide receive public inquiries about hundreds of national charities. (This chart shows the distribution of these information requests by category of charity.) Information on these most-asked-about charities appear in CBBB's Annual Charity Index.

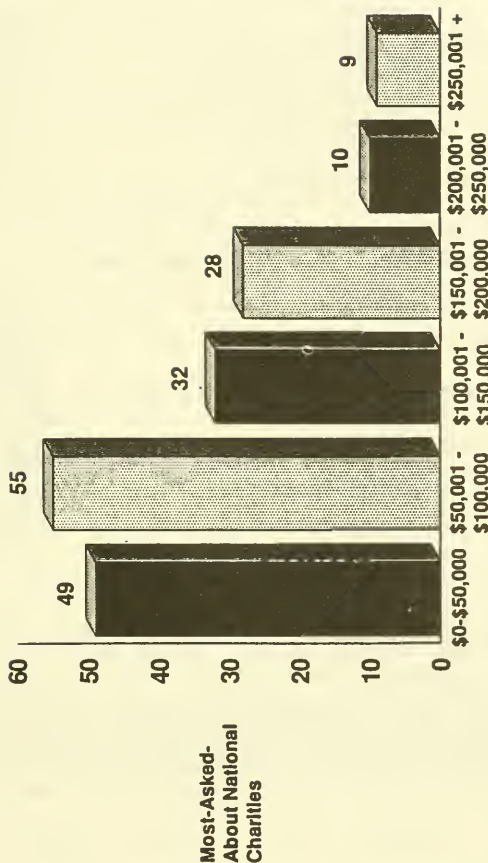
77% Meet Standards



23% Don't Meet Standards

As of August 1992, 23% of the most-asked-about national charities reviewed by PAS do not meet one or more of the CBBB Standards for Charitable Solicitations.

1991 Compensation of Chief Executive Officers of the Most-Asked-About Charities



1991 Total CEO Compensation
(Annual compensation plus benefit plans and expense accounts)

Source: Philanthropic Advisory Service, Council of Better Business Bureaus, Arlington, V.A. This chart shows the results of a survey sent to the most-asked-about national charities. Of surveys distributed to 203 national charities, 183 (90%) of these provided compensation figures for their chief executive officers, CEOs. The chart shows the distribution of total 1991 CEO compensation among these organizations. (The totals reflect the annual 1991 CEO compensation plus, if applicable, contributions to CEO benefit plans and CEO expense account and other allowances.) Specific 1991 CEO compensation figures appear in CBBB's Annual Charity Index (fourth edition).

TOP 1991 CHARITY CEO COMPENSATION AND INCOME LEVELS

The 10 Highest CEO Compensations

<u>Total 1991 CEO Compensation</u>	<u>Name of Charity</u>	<u>Charity Income</u>
\$441,971 ¹	United Way of America	\$ 33,233,000 ¹
\$392,000	City of Hope	\$157,972,000 ¹
\$308,613	American Heart Association	\$288,489,000
\$301,672	Save the Children Federation	\$ 90,757,000 ¹
\$299,083	National Wildlife Federation	\$ 88,537,000
\$291,593	Muscular Dystrophy Association	\$118,819,046 ¹
\$277,425	Boy Scouts of America	\$ 90,577,000 ¹
\$270,745	U.S. Olympic Committee	\$ 48,220,000 ¹
\$258,078	United Jewish Appeal	\$668,237,000
\$237,000	People-to-People Health Foundation	\$ 47,785,000 ¹

The 10 Highest Charity Income Levels

<u>Charity Income</u>	<u>Name of Charity</u>	<u>Total 1991 CEO Compensation</u>
\$1,465,557,000 ¹	American Red Cross	\$ 0 ²
\$ 668,237,000	United Jewish Appeal	\$258,078
\$ 503,915,000	Shriners Hospital for Crippled Children	\$162,136
\$ 365,497,000 ¹	American Cancer Society	\$224,164
\$ 293,508,000 ¹	Care	\$137,103
\$ 288,489,000	American Heart Association	\$308,613
\$ 220,027,000 ¹	Catholic Relief Services	\$123,768
\$ 215,513,000 ¹	World Vision	\$164,770
\$ 172,990,000	Nature Conservancy	\$199,075
\$ 157,972,000 ¹	City of Hope	\$392,000

¹ Reflects Fiscal 1990 Information.

² Elizabeth Dole declined a salary of \$200,000 and served as a volunteer in 1991. Since February 1992 she has been compensated at this \$200,000 annual rate.

³ Compensation figures are for former president William Aramony. Interim president Kenneth Dam served without pay in 1992.

Source: Philanthropic Advisory Service, Council of Better Business Bureaus, Arlington, VA. All CEO compensation and income levels are for the 203 most-asked-about nationally soliciting charities in America, as determined by consumer inquiries made to PAS and local BBB's. Of these 203 charities, a total of 183 (90 percent) provided information about CEO compensation and, if applicable, contributions to CEO benefit plans and related expense accounts and/or other allowances. Charity income levels are for fiscal 1990 or 1991, depending on the most recent data provided by charities to PAS. Additional information about charity CEO compensation and income levels appears in the CBBB's Annual Charity Index (fourth edition).

Chairman PICKLE. I thank you for your suggestions.

We agree with some and on some we might have questions. I am glad to have your suggestions and I appreciate them.

I don't know how, as you say Congress is going to weaken the accountability of these charities. Tell me again what do you think Congress might do to weaken your accountability?

Mr. WEINER. I was referring to intervention between the charities' boards and staff in terms of their accountability in making the decisions on appropriate compensation and other personnel matters within the organization.

Chairman PICKLE. How does Congress hinder that relationship?

Mr. WEINER. Their decision is removed if there is a cap, for example, on the amount that a charity can pay a particular charity staff member. That removes the charity's board from making those decisions.

Chairman PICKLE. I noticed your pamphlet here, "Give, But Give Wisely." It is a good pamphlet. I notice also that I think you charge \$2 for it in some places. You state, the organizations below have either declined to provide information or have not provided the requested information, despite at least three written requests. These organizations have not provided such information to the Council of Better Business Bureaus as of January 1993. You list some of those organizations.

One you list is David Livingston Missionary Foundation, the Don Stewart Association. I guess the Don Stewart Association.

Have you ever received anything from them? Do you know any more about that?

Mr. WEINER. In recent years, we have not received information from those organizations. I cannot speak to the full history of our file.

Chairman PICKLE. Another organization listed is the Robert Tilton Ministries, the Word of Faith World of Outreach Church Centers. What information did you request of Robert Tilton?

Mr. WEINER. Information that we requested from all of those organizations is the same. We have a questionnaire form that requests 27 different points of information, along with a possible 17 additional enclosures and some are the financial statements, board roster of the organization, the annual report, the articles of incorporation, bylaws, information about fundraising agreements they have with outside fundraising firms, et cetera.

Chairman PICKLE. Have you ever received any information from the Tilton Ministries?

Mr. WEINER. I do recall that I believe maybe roughly 3 years ago, they provided some limited information about their operations, but they did not provide all the information that we had requested.

Chairman PICKLE. Thank you, Mr. Weiner.

Mr. McCabe.

STATEMENT OF THOMAS E. McCABE, CHAIRMAN, EVANGELICAL COUNCIL FOR FINANCIAL ACCOUNTABILITY

Mr. McCABE. Thank you, Mr. Chairman.

My name is Thomas McCabe and I serve as chairman of the Evangelical Council for Financial Accountability, which would be

best referred to as ECFA. Mr. Clarence Reimer serves as president of ECFA.

Thank you for the opportunity to present our insights and recommendations based on our experience monitoring and regulating evangelical ministries over the past 14 years.

The establishment of ECFA in 1979, was largely motivated by the desire on the part of several Christian organizations to improve credibility, accountability and disclosure practices voluntarily as opposed to increased government regulations and reporting requirements. The effort was to enhance public trust by encouraging nonprofit ministries to practice full disclosure in their financial and fundraising endeavors. It was considered the right thing to do.

Several scandals in the late 1970s led Congressmen to introduce legislation to further regulate the activities of nonprofit organizations. ECFA was created with the earnest desire to ensure that evangelical Christian organizations set an example of full financial disclosure, quality accounting and reporting, compliance with Federal, State and local regulations and conformity with ECFA standards for membership.

Unfortunately, scandals in the nonprofit arena, including those in religious and evangelical organizations, did not end in the late 1970s, as we know. They surfaced again in the mid-1980s and continue to surface even in the early 1990s.

It is apparent that no amount of voluntary adherence or even mandatory requirements to maintain compliance with certain standards is ever going to totally eliminate any possibility of unethical or fraudulent behavior on the part of a few, and we believe it is a very few, nonprofit organizations, religious or otherwise. We are convinced that the need for accountability exists and nonprofits should be expected to fulfill certain standards.

ECFA requires continual strict adherence to its standards on the part of all member organizations. The means of measuring compliance of member organizations has been increasingly fine tuned over the years to provide greater assurance that members are in good-faith compliance with the ECFA standards at all times.

In addition to requiring compliance with the standards enunciated in our written testimony, ECFA reviews samples of each member organization's fundraising appeals as well as the receipting device to ensure compliance with fundraising standards. Several of the standards, 7.1 through 7.12, those standards which relate to fund raising, come directly from IRS regulations and charitable solicitation laws.

For example, ECFA has paid close attention to its members that use premiums and incentives in their fundraising appeals, to ensure that they reflect the fair market value of items given in exchange for a donation and inform donors that value is not tax deductible.

With this very brief introduction to ECFA, and I have shortened some of my comments in the oral testimony, I am pleased now to respond to some of the items identified in your June 3 letter regarding the 990 form and proposed legislation. I will devote this time now to addressing selected questions or issues which I believe to be of greatest significance.

First, 990 information. Information currently available in independently audited financial statements that is not reflected on a 990 form, is primarily in the form of disclosures contained in the notes to the financial statements. The notes are often the most meaningful and informative part of the financial statements.

The most significant items are details about the nature of the organization and its activities as well as additional disclosures concerning financial and related party transactions which might be items that could be incorporated into the 990.

Another issue is 990 accuracy. In order to improve the information and accuracy of the form 990, we believe that preparers must be better trained on the nature of the information that is being requested and that they must also take seriously the need to provide accurate and informative information.

We would suggest that the IRS make a special effort to provide further training and information to assist organizations and individuals involved in preparing the 990 form accurately. This should be directed at both understanding the form as well as the underlying principles and issues.

The 990 information is comprehensive and complex to the average nonprofit volunteer or employee. The complexity of underlying principles and issues, as well as the significant information gathering required to complete the form, provide for a high potential for inaccuracies or lack of complete information.

We would suggest more interaction with organizations when it appears that the forms have not been properly completed. Because the form does not produce a tax remittance, it appears that the IRS does not pay close attention to the forms unless or until an organization is being looked at more closely.

Perhaps a compliance review could be made of selected returns that would initiate questions on more obvious errors and omissions. This should serve the purpose of making constituents aware that the form is taken seriously and is paid attention to by the IRS.

In your letter of June 3, you asked about certain results of ECFA field reviews. Upon completion of over 100 field reviews since 1989, ECFA has increased the knowledge among its members of the requirements of ECFA and the IRS regulations which affect them.

ECFA has also succeeded in developing stronger relationships with the boards of its member organizations. We believe that working with nonprofit boards toward excellence and understanding of their legal responsibilities will result in greater care and ability by those boards to abide by all pertinent regulations. ECFA performs field reviews on approximately 6 percent of its over 720 member organizations annually.

Since members are selected randomly for review, the awareness that ECFA may choose their particular organization for an onsite review makes most organizations that much more careful to continually abide by the standards. In the course of field reviews ECFA representatives frequently discover that though the member organization has an audit review committee on paper, it is often not functioning.

In these cases, organizations are provided with a commentary on ECFA's Standard No. 2, which delineates the specific responsibilities of the audit review committee. The organization is asked to

inform ECFA of its progress in abiding by this section of Standard No 2.

On occasion during the field reviews, members are asked to seek professional counsel to determine whether they may be subject to UBIT or if their reporting of housing allowances is handled appropriately.

You asked about our efforts with regard to compensation. While no final recommendations to the ECFA board have come from the ECFA Standards Committee to date, they are pursuing this activity and the possibility exists to establish standards for determining reasonable compensation.

The ECFA application form and annual membership review forms ask for compensation information of the five highest paid employees of the organization. The following information is reported to ECFA in dollar amounts: current annual salary, royalties and/or bonuses, other fringe benefits, including such things as hospitalization, life insurance premiums, housing or car allowances and tuition payments. Also, expense account information. All these figures are added together to reflect total compensation.

The Standards Committee of ECFA is currently working on a recommendation to establish guidelines and perhaps even standards for determining reasonable compensation among ECFA members. We would be pleased to report the recommendations of our Standards Committee to the Subcommittee on Oversight once they are determined and approved by the ECFA board.

Form 990 disclosures. We think it is important that the 990 form identify all related entities as well as transactions with related parties, including related not-for-profit and for-profit organizations from which employees, officers, directors and their related parties may receive compensation or other financial interest.

The information should lead a reader to be able to tie together other organizations whereby an individual or related party might receive financial benefit or multiple compensation arrangements. Of particular concern would be business entities that contract and do business with an organization with which board members and employees or their related parties have an ownership or other financial interest.

Schedule A, part 3, question 2 of the 990 form, asks for disclosure of transactions with individuals and taxable entities but not all related parties. Schedule A, part 7 deals with noncharitable exempt organizations and tax-exempt organizations, other than those described in section 501(c)(3) of the Internal Revenue Code.

We would suggest that all the above be consolidated under the area of related entities and related party transactions for clarity; also that transactions with other related 501(c)(3) organizations be identified. We would reference for your information an exposure draft dated May 19, 1993, by the American Institute of Certified Public Accountants, entitled: "Reporting of Related Entities By Not-For-Profit Organizations." This document proposes new standards and includes reference to FASB No. 57, concerning related party transactions.

Concerning the proposed legislation, we believe that the 5-percent excise tax proposed to be levied upon organizations and individuals engaged in acts of private inurement, private benefit, self-

dealing and unreasonable compensation, would put a degree of seriousness and concern upon the managers of organizations to be sure they are within safe harbors in their actions but we would suggest that the IRS provide information to inform the public about what these are.

We do not believe that there is at present a good understanding about what constitutes private inurement and benefit or self-dealing, either among donors or the organizations themselves.

Concerning the proposed concept of granting tax exemption for limited periods of time, we do not feel that this is a workable proposal. We believe that it will be difficult to administer and would be unfair to organizations that need to establish long-term donor relationships and ongoing programs which might be jeopardized, inhibited or severely damaged, if there is not the ability to continue those programs in perpetuity as the need continues.

I am not sure I fully understand the phrase dealing with the additional section in which an organization would need to report payment of addition taxes for self-dealing, prohibited political activity, excessive lobbying and unrelated business income, but it would appear to encourage reasonable disclosure. Currently, not-for-profit organizations are required to have copies of the 3 most recent years of form 990 filed with the IRS available on site for public inspection.

I understand that some consideration is being made to require that nonprofits be willing, as some are already doing, to supply copies of the recent 990 forms by mail to those who request it. ECFA would not be opposed to such a requirement and would participate in educating its members of such regulations, if they are made law.

In conclusion, I would like to reiterate ECFA's firm belief that extensive additional legislation targeting all nonprofits in response to the misdeeds of a few, may be overkill and indeed could mean the end of many worthy charitable causes.

Fine tuning or enhancing the 990 form to gain more meaningful information may well be in order, but even more in order are efforts to educate nonprofits and assist them in meeting existing IRS requirements. Nonprofits are currently faced with the possibilities of massive postal rate increases, have been asked to bear greater responsibility in addressing social, spiritual, physical and cultural needs in our society, and all of this with ever-dwindling government funding.

In addition, they are expected to adhere to various State solicitation laws that are static at best. Problems of excessive compensation, deceptive fundraising, conflict of interests, self-dealing and the like, are in the clear minority of nonprofit organizations.

More concentration needs to be made toward empowering nonprofits to operate fully within the bounds of current law with all the tools necessary to carry out there programs effectively.

Thank you for the opportunity to testify at this hearing.

My colleagues and I are prepared to answer any questions you may have at this time.

[The prepared statement and a letter follow:]

Written Testimony
of the
Evangelical Council for Financial Accountability (ECFA)
before the
U. S. House of Representatives
Subcommittee on Oversight, Committee on Ways and Means
June 15, 1993

My name is Thomas McCabe and I am Chairman of the Evangelical Council for Financial Accountability (ECFA). With me are Mr. Clarence Reimer, President of the ECFA, and Mr. Gregg Capin, CPA with the Capin, Crouse & Co. accounting firm. Thank you for the opportunity to present our insights and recommendations based on our experiences with regulating evangelical ministries over the past 14 years.

ECFA was founded in 1979 with the purpose of providing a "self-regulatory" body which promotes financial accountability and integrity among nonprofit Christian ministries. The ECFA mission is "To help Christ-centered evangelical nonprofit organizations earn the public's trust through their ethical practices and financial accountability." Though membership in ECFA is sought voluntarily, and ECFA does not exercise its authority over nonmember organizations, we believe that the ECFA standards for membership provide a solid framework of operation for not only evangelical nonprofit organizations, but all nonprofit organizations. The establishment of ECFA was largely motivated by the desire of many Christian organizations to improve credibility, accountability, and disclosure practices voluntarily as opposed to increased government regulations and reporting requirements. The effort was to enhance public trust by encouraging nonprofit ministries to practice full disclosure in their financial and fund raising endeavors. It was considered the right thing to do. Several scandals in the late 70's led congressmen to introduce legislation to further regulate the activities of nonprofit organizations. ECFA was created with the earnest desire to ensure that evangelical Christian organizations set an example of full financial disclosure, quality accounting and reporting, compliance with Federal, State and local regulations, and conformity with the ECFA Standards for membership.

Unfortunately, scandals in the nonprofit arena, including those in religious and evangelical organizations, did not end in the late 70's, as we well know. They surfaced again in the mid 1980's, and continue to surface in the 1990's. It is apparent that no amount of voluntary adherence or even mandatory requirements to maintain compliance with certain standards is ever going to totally eliminate any possibility of unethical or fraudulent behavior on the part of a few (and we believe it is a very few) nonprofit organizations, religious or otherwise. We are convinced that the need for accountability exists, and nonprofits should be expected to fulfill certain standards. However, we are not convinced that greater government intervention, increased reporting requirements, short term tax exempt privileges, etc., would provide any greater deterrent for inaccurate, incomplete reporting, or in the rare cases, blatant fraud. Enough regulations already exist at the Federal and local government levels. In addition, associations such as ECFA, the National Charities Information Bureau (NCIB), and the Philanthropic Advisory Service of the Council of Better Business Bureaus, exist to assist donors in making decisions about their charitable giving, and to require adherence to a strict set of standards for ethics and financial accountability. There also exist a variety of organizations established to promote excellence in nonprofit management, board governance and fund raising. I cite Independent Sector and the National Center for Nonprofit Boards as examples.

ECFA has rapidly responded to the call for greater accountability and enhanced monitoring of its members by strengthening its standards and creating more effective means of enforcing those standard. It has become apparent over the years that ECFA members desire to be above reproach in their compliance with ECFA Standards, IRS regulations, and any applicable state and local regulations. In actuality, we believe that most nonprofit organizations are committed to fulfilling their missions in the most productive, cost-efficient manner, with sincere interest in abiding by the letter and the spirit of the laws governing nonprofits. Most nonprofit leaders are more interested in their cause than personal gain; and inaccuracies in IRS reporting or failure to comply with IRS regulations are largely due to ignorance, oversight or a need for education and assistance and not due to any malfeasance.

ECFA requires continual strict adherence to its Standards on the part of all member organizations. The means of measuring compliance of member organizations have been increasingly fine-tuned over the years to provide greater assurance that members are in good faith compliance with ECFA Standards at all times. To address the questions presented in your letter, I will briefly discuss each of the ECFA Standards of Responsible Stewardship and ECFA's procedures for enforcing those standards.

Standard No. 1: "Every member organization shall subscribe to a written statement of faith clearly affirming its commitment to the evangelical Christian faith and shall conduct its financial and other operations in a manner which reflects those generally accepted Biblical truths and practices."

While this standard clearly limits the types of nonprofit organizations that may qualify for membership in ECFA, the principles of Biblical Christianity set the ideal for ethics and integrity at a basic level. By adhering to this standard, members state a commitment to carrying out their program services with standards of excellence which are derived from clear moral teachings and personal convictions which would preclude illegal, unethical or dishonest behavior.

Standard No. 2: "Every member organization shall be governed by a responsible board of not less than five individuals, a majority of whom shall be other than employees/staff and/or those related by blood or marriage, which shall meet at least semi-annually to establish policy and review its accomplishments. The board shall appoint a functioning audit review committee, a majority of whom shall be other than employees/staff and/or those related by blood or marriage, for the purpose of reviewing the annual audit and reporting its findings to the board."

Effective board governance is critical to any discussion of accountability. Behind any effective organization, be it for-profit or nonprofit, is an active, informed, committed, responsible board of directors. A successful board which is faithfully exercising its responsibilities will help to prevent situations where unreasonable compensation (be it too high or too low), private benefit, self-dealing, and conflicts of interest occur. Virtually every time that ECFA has encountered some noncompliance among its membership, the problems stemmed from a lack of effective governance on the part of the board of directors. Because of this, ECFA requires its members to provide evidence that they have a responsible governing board that meets regularly to properly provide oversight. This includes, but is not limited to, submitting a list of board members annually to ECFA, indicating name, address, principal employer, and occupation. They are required to indicate any family relationships that exist with other board or staff members, and inform ECFA of who serves as Chairman of the Board and Chairman of the Audit Review Committee.

In addition, all related party transactions among board members must be disclosed. Members must be prepared to supply recorded minutes of board meetings, and evidence of at least two board meetings annually. The minutes should reflect board members absent as well as those present. Any board members with a potential for a conflict of interest in any decisions must be excused from voting or otherwise influencing that decision of the board. Minutes of board meetings should reflect that the board is fulfilling its responsibilities, and should be signed by the Secretary of the Board.

Experience has led us to conclude that proper functioning of a nonprofit board is critical to the organization's ability to operate effectively and completely within the parameters of IRS regulations and its tax-exempt purposes. For this reason, ECFA regularly addresses the subject of strong board governance, with practical information and resources to build up the nonprofit board.

The recent hot topic of nonprofit executive compensation is related to board governance. Nonprofit organizations vary greatly in size, scope, purpose, mission, number of employees and/or volunteers, and location, so that no bright line exists which clearly denotes a threshold of "reasonableness" in compensation. Therefore, it is incumbent upon the nonprofit board to establish compensation for its Chief Executive Officer, as well as his or her performance objectives and procedures for a regular appraisal of the CEO. The CEO is employed at the pleasure of the Board, and not vice versa. This is one reason that ECFA

requires its member organizations to maintain a majority on the board that are not related by blood or marriage to other board members or staff members. ECFA is now considering a move to strengthen Standard No. 2 even further by requiring that the positions of CEO and Chairman of the Board be held by two different, unrelated individuals.

Standard No. 3: "Every member organization shall obtain an annual audit performed by an independent public accounting firm in accordance with generally accepted auditing standards (GAAS) with financial statements prepared in accordance with generally accepted accounting principles (GAAP)."

The required financial statements provide the greatest level of independent verification of the fair presentation of a member organization's financial position. Each member is required to submit an audit to ECFA annually, which provides an independent auditor's opinion on the organization's financial statements. These audits often include information about related party transactions, and the nature of the exemption of the organization. Often the audit is accompanied by a letter from the auditing firm to the organization's board and management, indicating any recommendations to improve internal controls and accounting procedures. ECFA now requires that a copy of this "management letter" be submitted with the Annual Membership Review. It serves to further apprise ECFA of the organization's management practices.

Several ECFA members have been terminated from membership due to failure to supply the required audited financial statements. It has consistently been the determination of the ECFA Standards Committee that this requirement cannot be compromised by a waiver, or by acceptance of financial statements which are lesser in scope than a full GAAP audit.

ECFA does recognize that it is not always economically feasible for smaller organizations to obtain an independent audit. There are a number of very small organizations (under \$100,000 in total revenues annually) that are members in good standing with ECFA. However, ECFA recently placed an age and size limit on organizations applying to ECFA. Any applying organization must have been in operation for at least one year from the date it received its tax-exemption determination letter from the IRS, and have in excess of \$50,000 in annual revenue. This prevents very small, upstart organizations from being unduly burdened by the expense of an annual audit.

Standard No. 4: "Every member organization shall exercise management and financial controls necessary to provide reasonable assurance that all resources are used (nationally and internationally) to accomplish the exempt purposes for which they are intended."

This standard represents ECFA's latest effort to enhance the reporting and accounting for transferred funds. As ECFA's newest Standard, it has not yet been enforced to the extent that failure to comply could cause a member to lose its membership. ECFA is working with organizations towards compliance with this Standard throughout 1993. Compliance is to be enforced in 1994. Efforts to date in promoting this Standard have included requesting policy statements and board minutes which reflect approval for transfer of funds and the circumstances in which such transfers may occur. Members are asked to monitor expenditures of funds sent to foreign-based operations or unaffiliated U.S. organizations to the extent that their board is satisfied that the exempt purposes of the organization are being carried out as intended.

Many organizations are involved in deploying their own personnel overseas to conduct the organization's own mission. In such circumstances, supervisory roles exist and there are not often language and cultural barriers impeding communication and reporting expectations. It is in cases where an organization considers supporting personnel or projects with which it has no organizational ties; e.g., an unaffiliated domestic or foreign organization, that the organization must first review the unrelated project or work to determine that it is consistent with its own exempt purposes. If so, the organization must establish policies and procedures for reviewing progress, accounting for expenditures, and doing appropriate audits. Evidence that such policies exist and are implemented must be presented to ECFA.

Standard No. 5: "Every member organization shall provide a copy of its current audited financial statements upon written request."

Standard No. 5 specifically deals with financial disclosure. At the core of ECFA's purpose is its commitment to appropriate public disclosure. An up-front, confident provision of financial information upon written request enhances a nonprofit's credibility before the public. ECFA supports (and enforces when necessary) disclosure of the Form 990 in accordance with federal law. In addition, ECFA requires its members to send a complete copy of its most recent audited financial statements to anyone making a request in writing. The audit should be available in a timely manner from the close of the organization's fiscal year. ECFA allows between 4 to 7 months from its members' respective fiscal year ends to supply an audit for that fiscal year.

ECFA does not require its members to provide public disclosure of specific salary information beyond that which is reported in the 990. However, such disclosure is encouraged by ECFA. The basic premise behind ECFA's disclosure requirements and additional disclosure recommendations is full transparency before the public which in turn increases public confidence. The numbers revealed in financial statements are not always so important to the donor public as much as the fact that they are disclosed in the first place. ECFA has on occasion received complaints about member organizations which have been hesitant or even unwilling to provide a copy of the audited financial statement upon written request. Many organizations fear that the information will be misinterpreted and used against them. In such cases, ECFA intervenes, and reminds members that financial disclosure is required regardless of who is asking or for what purpose they are asking. The member in question is asked to provide the audit to the inquirer within a set period of time (usually two weeks from receipt of ECFA's letter) with a copy of their response sent to ECFA. In every case that ECFA has been required to enforce this standard, the member in question promptly complied in order to protect its membership in ECFA.

Related to the issue of disclosure is the concern over fair representations of allocations of costs. The assumption that one ministry reporting that it spends 95 cents of every dollar on program services is necessarily more efficient than another ministry reflecting only 70 cents for every dollar expended on program services is a myth. There are no standardized reporting requirements for allocating costs into categories of fund raising, general and administrative, and program services expenses, either from the IRS or the accounting profession. Organizations may determine cost allocations in a variety of different ways. ECFA has steered clear of assessing a member's effectiveness or efficiency based on percentages of such costs. This is largely due to the many variables affecting such reporting. Newer organizations in their cash poor formative years are necessarily going to incur greater overhead costs in the start-up of their work. It does not necessarily reflect inefficiency. Too often donors and other users of financial information fail to make an apples to apples comparison of how various costs are allocated. ECFA is following the efforts of the Financial Accounting Standards Board (FASB) related to uniform accounting procedures for nonprofits. It is not an issue without controversy, so no immediate determinations are expected. In addition, ECFA is keeping aware of the efforts of the Association of Evangelical Relief & Development Organizations (AERDO) on the subject of recording and accounting for gifts-in-kind; another issue that affects nonprofit accounting and impressions left by a review of nonprofit financial reports. AERDO Standards require that gifts-in-kind be recorded at wholesale or less, while many charities will record such gifts at retail, and some charities at inflated values.

Standard No. 6: "Every member organization shall avoid conflicts of interest. Transactions with related parties may be undertaken only if all of the following are observed; 1) a material transaction is fully disclosed in the audited financial statements of the organization; 2) the related party is excluded from the discussion and approval of such transaction; 3) a competitive bid or comparable valuation exists; and 4) the organization's board has acted upon and demonstrated that the transaction is in the best interest of the member organization."

The intent of this Standard is to provide additional assurance to donors and other supporters that financial transactions are conducted fairly and are in the best interests of the

organization. It is also intended to provide for a more impartial environment which will support fairness in decision making. A conflict of interest can arise when a donor, board member or other influential person tries to conduct business with the organization in such a way as to gain some personal benefit. This can range from trying to "pass-through" gifts to individuals while obtaining a tax receipt, to promising future gifts if the organization conducts business with an individual or their company. All conflicts of interest are related party transactions. Not all related party transactions are conflicts of interest. It is the goal of Standard No. 6 to assist members in maintaining ethical business practices and require certain documentation which substantiates the veracity of any related party transactions.

Conflicts of interest/related parties means yourself, your spouse, family members, business interests, and/or associates. Conflicts of interest may arise when one party has the ability to significantly influence the management or operations of the other, to the extent that one of the transacting parties might be prevented from fully pursuing the interests of the nonprofit organization rather than his/her own separate or related party interests.

Not only has ECFA required its members to demonstrate that any related party transactions are indeed in the best interests of the organization and conducted in verified "arms length" agreements, but also ECFA has begun to encourage its members to develop and implement a conflicts of interest policy.

Standard No. 7: "Every member organization shall comply with each of the ECFA standards for Fund Raising."

- 7.1 *"All representations of fact, description of financial condition of the organization, or narrative about the events must be current, complete and accurate. References to past activities or events must be appropriately dated. There must be no material omissions or exaggerations of fact or use of misleading photographs or any other communication which would lead tend to create a false impression or misunderstanding."*
- 7.2 *"Fund raising appeals must not create unrealistic donor expectations of what a donor's gift will actually accomplish within the limits of the organization's ministry."*
- 7.3 *"All statements made by the organization in its fund raising appeals about the use of the gift must be honored by the organization. The donor's intent is related to both what was communicated in the appeal and to any donor instructions accompanying the gift. The organization should be aware that communications made in fund raising appeals may create a legally binding restriction."*
- 7.4 *"An organization raising or receiving funds for programs that are not a part of its present or prospective ministry, but are proper in accordance with its exempt purpose, must either treat them as restricted funds or channel them through an organization that can carry out the donor's intent, or return the funds to the donor."*
- 7.5 *"Organizations making fund raising appeals which, in exchange for a contribution, offer premiums or incentives (the value of which is not insubstantial, but which is significant in relation to the amount of the donation) must advise the donor of the fair market value of the premium or incentive and that the value is not deductible for tax purposes."*
- 7.6 *"On request, an organization must provide a report, including financial information, on the project for which it is soliciting gifts."*
- 7.7 *"Compensation of outside fund raising consultants based directly or indirectly on a percentage of what is raised, or on any other contingency agreement, may create potential conflicts and opportunities for abuse. Full disclosure of such agreements is required, at least annually, in the organization's audited financial statements, in which the disclosure must match income and related expenses. Compensation to the organization's own employees on a percentage basis or a contingency basis is not allowed."*
- 7.8 *"Tax deductible gifts may not be used to pass money or benefits to any named individual for personal use."*
- 7.9 *"An officer, director, or other principal of the organization must not receive royalties for any product that is used for fund raising or promotional purposes by his/her own organization."*
- 7.10 *"Property or gifts in kind received by an organization, should be acknowledged describing the property or gift accurately without a statement of the gift's market value. It is the responsibility of the donor to determine the fair market value of the property for tax purposes. But the organization should inform the donor of IRS reporting requirements for all gifts in excess of \$5,000."*
- 7.11 *"An organization must make every effort to avoid accepting a gift from or entering into a contract with a prospective donor which would knowingly place a hardship on the donor, or place the donor's future well-being in jeopardy."*

- 7.12 *"The representative of the organization, when dealing with persons regarding commitments on major estate assets, must seek to guide and advise donors so they have adequately considered the broad interests of the family and the various ministries they are currently supporting before they make a final decision. Donors should be encouraged to use the services of their attorneys, accountants, or other professional advisors."*

ECFA reviews samples of each member organization's fund raising appeals, as well as the receipting device, to ensure compliance with the Fund Raising Standards. Several of the Standards 7.1 through 7.12 (those Standards related to fund raising) come directly from IRS regulations and charitable solicitation laws. For example, ECFA has paid close attention to its members that use premiums and incentives in their fund raising appeals to ensure that they reflect the fair market value of items given in exchange for a donation, and inform donors that that value is not tax-deductible.

Having described the purpose, Standards, frequently encountered issues among members, and procedures of ECFA; and having expanded on some of the issues that have been of greatest concern to ECFA, I will now respond to the eleven items delineated in paragraph four of your June 3 letter.

1) **990 Information:** Information currently available in independently audited financial statements that is not reflected in the Form 990 is primarily in the form of disclosures contained in the notes to the financial statements. The notes are often the most meaningful and informative part of the financial statements. The most significant items are details about the nature of the organization and its activities, as well as additional disclosures concerning financial and related party transactions which might be items that could be incorporated into the 990. The 990 includes information about most significant issues and elements. We would suggest adding to the 990 a section that explicitly states the organization's IRS approved "exempt purposes," so that reference could be made to current activities and expenditures.

2) **990 Accuracy:** In order to improve the information on and accuracy of the Form 990, we believe that preparers must be better trained on the nature of the information that is being requested and that they must also take seriously the need to provide accurate and informative information. We would suggest that the IRS make a special effort to provide further training and information to assist organizations and the individuals involved in preparing the 990 form accurately. This should be directed at both understanding the form as well as the underlying principles and issues. The 990 information is comprehensive and complex to the average nonprofit volunteer or employee. The complexity of underlying principles and issues as well as the significant information gathering required to complete the form provide for a high potential for inaccuracies or lack of complete information. I would also suggest more interaction with organizations when it appears that the forms have not been properly completed. Because the form does not produce a tax remittance, it appears that the IRS does not pay close attention to the forms unless or until an organization is being looked at more closely. Perhaps a compliance review could be made of selected returns that would initiate questions on more obvious errors and omissions. This should serve the purpose of making constituents aware that the form is taken seriously and paid attention to by the IRS.

3) **Results of ECFA Field Reviews:** The addition of ECFA's Field Review program in 1989 to the scope of ECFA's mission has greatly increased its ability to verify compliance among members. We have opportunity to meet with senior staff and board members, and review a greater volume of documentation not submitted with the original application form or the annual membership review form. The greatest results from the Field Reviews are educational--increased knowledge and adherence to ECFA Standards, IRS regulations, etc. Unless some egregious violations are unearthed, the field review program is not intended to lead to punitive action against members. The primary purposes of the field review are as follows:

- To confirm compliance with the ECFA Standards for membership.
- To verify information submitted by the member organization in its Annual Membership Review
- To identify areas of possible noncompliance with the ECFA Standards for membership.
- To give support to the member organization in moving toward full compliance with the spirit and intent of the ECFA Standards for membership.

Upon completion of over 100 field reviews since 1989, ECFA has increased the knowledge among members of ECFA requirements and IRS regulations which affect them. ECFA has also succeeded in developing stronger relationships with the boards of its member organizations. As stated before, working with nonprofit boards towards excellence and understanding of their legal responsibilities will result in greater care and ability by those boards to abide by all pertinent regulations. ECFA performs Field Reviews on approximately 6% of its over 720 member organizations annually. Since members are selected randomly for review, the awareness that ECFA may choose their particular organization for an on-site review makes each organization that much more careful to continually abide by the Standards.

4) Most Frequently Encountered Violations of ECFA Standards: In submitting Annual Membership Reviews, several members struggle with submitting the required audited financial statements in a timely manner. When members are terminated for failure to comply with one or more of the ECFA Standards, it is more often than not due to a failure to supply the required audit. We have established a policy whereby organizations can gain an extension to submit the audit if appropriate documentation is supplied from the organization's auditors and audit review committee indicating the reasons for the delay of the audit. In the course of Field Reviews, ECFA representatives frequently discover that though the member organization has an Audit Review Committee on paper, it is often not functioning. In these cases, organizations are provided with a Commentary on ECFA Standard No. 2 which delineates the specific responsibilities of the audit review committee. The organization is asked to inform ECFA of its progress in abiding by this section of Standard No. 2.

There are some boards of ECFA members that are in effect "rubber stamps" for agendas of the CEO or the Chairman of the Board. Rarely has ECFA encountered any malfeasance in these situations among members, but yet the potential exists. ECFA is committed to strengthening the accountability relationship between senior management, the board, and the donor public, and therefore will provide motivation for the boards of these organizations to be in keeping with the spirit and intent of ECFA Standard No. 2 rather than just an appearance of compliance on paper.

On occasion, during Field Reviews, members are advised to seek professional counsel to determine whether they may be subject to UBIT, or if reporting of housing allowances is handled appropriately.

5) Board Meeting Attendance and Voting: Every ECFA member is required to attest annually that their board met at least twice in the last year and that the majority of those in attendance and voting were non-family/non-staff board members. This is reported on the Annual Membership Review form, which requires the signature of the CEO, the Chief Financial Officer, and the Chairperson of the Board. In the event that the Chairperson of the Board is a staff person, some other non-salaried Board Officer may sign. These signatures are affirming that all information given in the Annual Membership Review fully and fairly describes the financial reporting, disclosure, and administrative practices of the member organization.

When an organization is chosen for a Field Review, board minutes are reviewed. The board minutes will bear the date of the meeting and the names of those present. This further assures that independent governance of the organization is in practice and not simply on paper.

One related comment, ECFA reviews the bylaws of all its member organizations to confirm that an independent board is the ultimate governing authority. In other words, we look for any loopholes or caveat statements in the bylaws which could allow one person veto power, or authority to "fire" the board. Finding such verbiage in bylaws could preclude compliance with Standard No. 2.

6) Standards Committee Efforts Re: Compensation: No final recommendations to the ECFA Board have come from the ECFA Standards Committee to date which would establish standards for establishing reasonable compensation. The ECFA application form and Annual Membership Review forms ask for compensation information of the five highest paid employees of the organization. The following is reported to ECFA in dollar amounts: current annual salary, royalties and/or bonuses, other fringe benefits (including such things as hospitalization, life insurance premiums, housing or car allowances, tuition payments, etc.), expense account. All these figures are added together to reflect total compensation. The Standards Committee is currently working on a recommendation to establish guidelines and perhaps standards for

determining reasonable compensation among ECFA members. We would be pleased to report the recommendations to the Subcommittee on Oversight of the House Ways and Means Committee once they are determined by the Standards Committee and approved by the ECFA Board.

Current ECFA activities in this area are directed at assisting members in establishing fair compensation levels. We are aware of the general guidelines offered by the IRS, including asking such questions as "Who determines the compensation?" or "Are there control measures in place?" and "Is compensation commensurate with duties?" We have advised members of the "three likes" test in IRC Section 162, where reasonable compensation is generally defined as that amount that "would ordinarily be paid for like services by like enterprises under like circumstances."

In addition to reviewing compensation information of ECFA members, and looking for "standout" examples of compensation which might be deemed unreasonable (in which cases, though very rare among ECFA members, further justification and substantiation for compensation levels are requested by ECFA), ECFA has encouraged its members to follow these additional guidelines in determining and monitoring compensation levels:

- Establish a Board subcommittee specifically for compensation review.
- Gather information in accordance with the "three likes" test.
- Consider ALL elements of compensation (both taxable and untaxable).
- Record Board approval of CEO compensation package in the formal board minutes.

7) **Related Party Transactions:** In considering what types of related party transactions have raised the potential for a conflict of interest, I would respond simply that ANY related party transaction has the potential for a conflict of interest if not properly managed and disclosed. There are many cases where an organization will benefit or save money or otherwise have its effectiveness enhanced by related party transactions. The problem comes when the related party has undue influence over the board or the management in conducting the transaction.

8) **990 Disclosures:** We think it is important that the 990 form identify all related entities, as well as transactions with related parties, including related not-for-profit and for-profit organizations, from which employees, officers, directors, and their related parties may receive compensation or other financial interest. The information should lead a reader to be able to tie together other organizations whereby an individual or related party might receive financial benefit or multiple compensation arrangements. Of particular concern would be business entities that contract and do business with an organization with which board members and employees or their related parties have an ownership or other financial interest.

Schedule A, Part III, Question 2 of the 990 asks for disclosure of transactions with individuals and taxable entities, but NOT all related parties. Schedule A, Part VII deals with non-charitable exempt organizations and tax-exempt organizations other than those described in Section 501(c)(3) of the Internal Revenue Code. We would suggest that ALL the above be consolidated under the area of related entities and related party transactions for clarity--also that transactions with other related 501(c)(3) organizations be identified. We would reference for your information an exposure draft dated May 19, 1993 by the American Institute of Certified Public Accountants (AICPA) entitled, "Reporting of Related Entities by Not-for-profit Organizations." This document proposes new standards and includes reference to FASB No. 57 concerning related party transactions.

9) **Lawsuits/Investigations/IRS Audit:** ECFA requires its members to reveal, in the information submitted for Annual Membership Review, the nature of any lawsuits in which they are involved and the expected outcome. They are usually of limited scope and treated with confidentiality. ECFA makes no recommendation on the public disclosure of lawsuits. If ECFA were to make such a recommendation, it would be largely dependent on the nature of the lawsuit and its relevance to ECFA Standards or its potential to threaten the viability of the organization or its continued tax-exempt status. To date ECFA has not encountered such lawsuits among its membership. During Field Reviews, ECFA representatives will review (with the organization's legal counsel present, if desired by the organization) legal documents pertaining to any lawsuits.

ECFA also asks if the organization has ever been audited by the IRS and if so, what the findings and determination were. Many times we find that members have been audited by the

IRS but have not yet received the results of the audit. In such cases ECFA will follow up with the organization until the audit results are available to ensure that the organization continues its IRS status. ECFA has not encountered an ECFA member which has been audited by the IRS where there was a negative outcome. A negative IRS audit determination could lead ECFA to suspend or terminate membership privileges.

10) Suggestions to Donors for Greater Assurance: Even with the best efforts of the IRS, ECFA, NCIB and BBB, there are no absolute guarantees that all charitable gifts will be used at all times, both nationally and internationally, for the stated exempt purposes. Nevertheless, it is ECFA's firm belief that an informed donor is the best friend of nonprofit organizations. Instilling confidence in donors should be a priority for nonprofits. In turn, donors need to ask questions and demand adequate answers before giving. If donors do not receive satisfactory responses, they should not give. There are plenty of worthy organizations which take seriously the commitment of accountability to the donor public that are prepared to give the assurance to donors that they deserve.

ECFA provides a Giver's Guide, which includes a "Donor's Bill of Rights," which encourages donors to recognize their right to:

- Know how the funds of an organization are being spent.
- Know what the programs they support are accomplishing.
- Know that the organization is in compliance with Federal, State, and municipal laws.
- Restrict or designate gifts to a particular project.
- A response to inquiries about finances and programs.
- Visit offices and program sites of an organization to talk personally with the staff.
- Not be highly pressured into giving to any organization.
- Know that the organization is well managed.
- Know that there is a responsible governing board and who those board members are.
- Know that all appeals for funds are truthful and accurate.

NCIB also provides a "Wise Giving Guide" which reports on certain charitable organizations and measures their compliance with NCIB standards. The Philanthropic Advisory Service of the BBB provides a publication entitled, "Give but Give Wisely."

A recent publication entitled, "Special Report: How to Protect Your Charity Donations from Fraud," by Rev. Joel MacCollam, President of World Emergency Relief, gives several specific suggestions for things that donors can do to gain confidence when making charitable contributions. They include the following:

- Ask questions. Legitimate charities will answer legitimate questions.
- Make checks payable to the charity, and not to the individual asking for the donation.
- Check charities out with one of the various monitoring groups (e.g. ECFA, BBB, or NCIB)
- Learn to read a charity's (or ministry's) audited financial statements.
- Visit the charity.
- Be sure the charity/ministry is properly registered with government agencies.
- Check local authorities for any complaints about a particular organization.
- Ask for a copy of the organization's IRS "determination letter."
- Get references.
- Be sure the charity will show you its IRS Form 990 filings for the past three years.

11) Public Disclosure of 990: ECFA, and other organizations in the evangelical community, have consistently, through training, made organizations aware of the public disclosure requirements of the law. We do not have specific information on compliance with that law, but also do not have complaints or other information to indicate that there is not compliance with the law. We believe that there are relatively few individuals who request such information from organizations. We have noted that it is also true that donors rarely request independently audited financial statements that are made available to the public. This may speak to the need for donors to become more interested in understanding and asking questions about the organizations that they support.

I do know that in the course of ECFA Field Reviews, ECFA representatives have discovered that most, if not all, of the members reviewed had a file with the three most recently filed 990s available on site for public inspection. I do not recall any of the organizations having been asked by any interested party to review the file.

Comments on Proposed Legislation:

Concerning the proposed legislation, we believe that the 5% excise tax proposed to be levied upon organizations and individuals engaged in acts of private inurement, private benefit, self-dealing, and unreasonable compensation, would put a degree of seriousness and concern upon the managers of organizations to be sure they are within safe harbors in their actions. We would suggest that the IRS provide information to inform the public about what these are. We do not believe there is at present good understanding about what constitutes private inurement and benefit or self-dealing, either among donors or the organizations themselves.

Concerning the proposed concept of granting tax exemption for limited periods of time, we do not feel that this is a workable proposal. I believe that it will be difficult to administer and would be very significantly unfair to organizations that need to establish long-term donor relationships and ongoing programs which might be jeopardized, inhibited, or severely damaged if there is not the ability to continue those programs in perpetuity as the need continues.

I am not sure I fully understand the phrase dealing with the additional section in which an organization would need to report the payment of additional taxes for self-dealing, prohibited political activity, excessive lobbying, and unrelated business income, but it would appear to encourage reasonable disclosure. I am also not sure what additional public access to Form 990 the Committee is considering.

Currently, nonprofit organizations are required to have copies of the three most recent years of Form 990 filed with the IRS available on-site for public inspection. It is my understanding that some consideration is being made to require that nonprofits be willing (as some are already doing) to supply copies of their recent 990 forms by mail to those who would request it (with allowance to charge reasonable amounts for duplication and postage). ECFA would not be opposed to such a requirement, and would participate in educating its members of such regulations if indeed they are made law.

In conclusion, I would like to reiterate ECFA's firm belief that extensive additional legislation targeting all nonprofits (in response to the misdeeds of a very few) may be overkill and indeed could mean the end of many worthy charitable causes. Fine tuning or enhancing the 990 form to gain more meaningful information may be in order. But even more in order are efforts to educate nonprofits and assist them in meeting existing IRS requirements. Nonprofits are currently faced with the possibility of massive postal rate increases; have been asked to bear greater responsibilities in addressing social, spiritual, physical and economic needs of society (with ever dwindling government funding), and adhere to strict state solicitation laws that are static at best. Problems of excessive compensation, deceptive fund raising, conflicts of interest, self-dealing, etc. are in the clear MINORITY of nonprofit organizations. More concentration needs to be made towards empowering nonprofits to operate fully within the bounds of current law, with all the tools necessary to carry out their programs most effectively.

[This testimony respectfully submitted by the Evangelical Council for Financial Accountability (ECFA), P.O. Box 17456, Washington, DC 20041-0456, Phone: 703/713-1414, Contact Person: Clarence Reimer, President]

EVANGELICAL
COUNCIL FOR
FINANCIAL
ACCOUNTABILITY



June 11, 1993

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Dear Representative Pickle:

Thank you for your letter of June 3, and your request for my testimony before the Subcommittee on Oversight of the Committee on Ways and Means on Tuesday, June 15. Mr. Clarence Reimer, President of the Evangelical Council for Financial Accountability (ECFA), Mr. Gregg Capin, CPA with the Capin, Crouse & Co. accounting firm, and I will be present at the hearing. Thank you for the opportunity to present our insights and recommendations based on our experiences with regulating evangelical ministries over the past 14 years.

ECFA was founded in 1979 with the express purpose of providing a "self-regulatory" body which promotes financial accountability and integrity among nonprofit Christian ministries. The ECFA mission is "To help Christ-centered evangelical nonprofit organizations earn the public's trust through their ethical practices and financial accountability." Though membership in ECFA is sought voluntarily, and ECFA does not exercise its authority over nonmember organizations, we believe that the ECFA standards for membership provide a solid framework of operation for not only evangelical nonprofit organizations, but all nonprofit organizations. In effect, the monitoring procedures in place at ECFA could set a model for excellence in the nonprofit sector as a whole.

The establishment of ECFA was largely motivated by the desire on the part of several Christian organizations to improve credibility, accountability, and disclosure practices voluntarily as opposed to increased government regulations and reporting requirements. The effort was to enhance public trust by encouraging nonprofit ministries to practice full disclosure in their financial and fund raising endeavors. It was considered the right thing to do. Several scandals in the late seventies led congressmen to introduce legislation to further regulate the activities of nonprofit organizations. ECFA was created with the earnest desire to ensure that evangelical Christian organizations set an example of full financial disclosure,

quality accounting and reporting, compliance with federal, state and local regulations, and conformity with the ECFA Standards for membership.

Unfortunately, scandals in the nonprofit arena, including those in religious and evangelical organizations, did not end in the late 70's, as we well know. They surfaced again in the mid 1980's, and continue to surface in the 1990's. It is apparent that no amount of voluntary adherence or even mandatory requirements to maintain compliance with certain standards is ever going to totally eliminate any possibility of unethical or fraudulent behavior on the part of a few (and we believe it is a very few) nonprofit organizations, religious or otherwise. We are convinced that the need for accountability exists, and nonprofits should be expected to fulfill certain standards. However, we are not convinced that greater government intervention, increased reporting requirements, short term tax exempt privileges, etc., would provide any greater deterrent for inaccurate, incomplete reporting, or in the rare cases, blatant fraud. Enough regulations already exist at the federal and local government levels. In addition, associations such as ECFA, the National Charities Information Bureau (NCIB), and the Philanthropic Advisory Service of the Better Business Bureau, exist to assist donors in making decisions about their charitable giving, and to require adherence to a strict set of standards for ethics and financial accountability. There also exist a variety of organizations established for the express purpose of promoting excellence in nonprofit management, board governance and fund raising. I cite Independent Sector and the National Center for Nonprofit Boards as examples.

ECFA has rapidly responded to the call for greater accountability and enhanced monitoring of its members by strengthening its standards and creating more effective means of enforcing those standards among members. It has become apparent over the years that ECFA members desire to be above reproach in their compliance with ECFA Standards, IRS regulations, and any applicable state and local regulations. In actuality, we believe that most nonprofit organizations are committed to fulfilling their missions in the most productive, cost-efficient manner, with sincere interest in abiding by the letter and the spirit of the laws governing nonprofits. Most nonprofit leaders are more interested in their cause than personal gain; and inaccuracies in IRS reporting or failure to comply with IRS regulations are largely due to ignorance, oversight or a need for education and assistance and not due to any malfeasance.

ECFA requires continual strict adherence to its Standards on the part of all member organizations. The means of measuring compliance of member organizations have been increasingly fine-tuned over the years to provide greater assurance that members are in good faith compliance with ECFA Standards at all times.

To address the questions presented in your letter, I will briefly discuss each of the ECFA Standards of Responsible Stewardship and ECFA's procedures for enforcing those standards.

Standard No. 1: "Every member organization shall subscribe to a written statement of faith clearly affirming its commitment to the evangelical Christian faith and shall conduct its financial and other operations in a manner which reflects those generally accepted Biblical truths and practices."

While this standard clearly limits the types of nonprofit organizations that may qualify for membership in ECFA, the principles of Biblical Christianity set the ideal for ethics and integrity at a basic level. By adhering to this standard, members state a commitment to carrying out their program services with standards of excellence which are derived from clear moral teachings and personal convictions which would preclude illegal, unethical or dishonest behavior.

Standard No. 2: "Every member organization shall be governed by a responsible board of not less than five individuals, a majority of whom shall be other than employees/staff and/or those related by blood or marriage, which shall meet at least semi-annually to establish policy and review its accomplishments. The board shall appoint a functioning audit review committee, a majority of whom shall be other than employees/staff and/or those related by blood or marriage, for the purpose of reviewing the annual audit and reporting its findings to the board."

The subject of effective board governance is critical to any discussion of accountability. Behind any effective organization, be it for-profit or nonprofit, is an active, informed, committed, responsible board of directors. A successful board which is faithfully exercising its responsibilities will help to prevent situations where unreasonable compensation (be it too high or too low), private

benefit, self-dealing, and conflicts of interest occur. Virtually every time that ECFA has encountered some noncompliance among its membership, the problems stemmed from a lack of effective governance on the part of the board of directors. Because of this, ECFA requires its members to provide evidence that they have a responsible governing board that meets regularly to properly provide oversight. This includes, but is not limited to, submitting a list of board members annually to ECFA, indicating name, address, principal employer, and occupation. They are required to indicate any family relationships that exist with other board or staff members, and inform ECFA of who serves as Chairman of the Board and Chairman of the Audit Review Committee.

In addition, all related party transactions among board members must be disclosed. Members must be prepared to supply recorded minutes of board meetings, and evidence of at least two board meetings annually. The minutes should reflect board members absent as well as those present. Any board members with a potential for a conflict of interest in any decisions must be excused from voting or otherwise influencing that decision of the board. Minutes of board meetings should reflect that the board is fulfilling its responsibilities, and should be signed by the Secretary of the Board.

Experience has led us to conclude that proper functioning of a nonprofit board is critical to the organization's ability to operate effectively and completely within the parameters of IRS regulations and its tax-exempt purposes. For this reason, ECFA regularly addresses the subject of strong board governance, with practical information and resources to build up the nonprofit board.

The recent hot topic of nonprofit executive compensation is related to board governance. Nonprofit organizations vary greatly in size, scope, purpose, mission, number of employees and/or volunteers, and location, so that no bright line exists which clearly denotes a threshold of "reasonableness" in compensation. Therefore, it is incumbent upon the nonprofit board to establish compensation for its Chief Executive Officer, as well as his or her performance objectives and procedures for a regular appraisal of the CEO. The CEO is employed at the pleasure of the Board, and not vice versa. This is one reason that ECFA requires its member organizations to maintain a majority on the board that are not related

by blood or marriage to other board members or staff members. Independent board governance is the key.

As mentioned in my previous letter, ECFA is considering a move to strengthen Standard No. 2 even further by requiring that the positions of CEO and Chairman of the Board be held by two different, unrelated individuals. The Chairman of the Board is chief volunteer, while the CEO is chief staff member.

Standard No. 3: "Every member organization shall obtain an annual audit performed by an independent public accounting firm in accordance with generally accepted auditing standards (GAAS) with financial statements prepared in accordance with generally accepted accounting principles (GAAP)."

The required financial statements provide the greatest level of independent verification of the fair presentation of a member organization's financial position. Each member is required to submit an audit to ECFA annually, which provides an independent auditor's opinion on the organization's financial statements. These audits often include information about related party transactions, and the nature of the exemption of the organization. Often the audit is accompanied by a letter from the auditing firm to the organization's board and management, indicating any recommendations to improve internal controls and accounting procedures. ECFA now requires that a copy of this "management letter" be submitted with the Annual Membership Review. It serves to further apprise ECFA of the organization's management practices.

Several ECFA members have been terminated from membership due to failure to supply the required audited financial statements. It is a technical violation of ECFA Standards, but a violation nonetheless, and it has consistently been the determination of the ECFA Standards Committee that this requirement cannot be compromised by a waiver, or by acceptance of financial statements which are lesser in scope than a full GAAP audit.

ECFA does recognize that it is not always economically feasible for smaller organizations to obtain an independent audit. There are a number of very small organizations (under \$100,000 in total revenues annually) that are members in

good standing with ECFA. However, ECFA recently placed an age and size limit on organizations to qualify to make application to ECFA. Any applying organization must have been in operation for at least one year from the date it received its tax-exemption determination letter from the IRS, and have in excess of \$50,000 in annual revenue. This prevents very small, upstart organizations from being unduly burdened by the expense of an annual audit.

Standard No. 4: "Every member organization shall exercise management and financial controls necessary to provide reasonable assurance that all resources are used (nationally and internationally) to accomplish the exempt purposes for which they are intended."

This standard represents ECFA's latest effort to enhance the reporting and accounting for transferred funds. As ECFA's newest Standard, it has not yet been enforced to the extent that failure to comply could cause a member to lose its membership. ECFA is working with organizations towards compliance with this Standard throughout 1993. Compliance is to be enforced in 1994. Efforts to date in promoting this Standard have included requesting policy statements and board minutes which reflect approval for transfer of funds and the circumstances in which such transfers may occur. Members are asked to monitor expenditures of funds sent to foreign-based operations or unaffiliated U.S. organizations to the extent that their board is satisfied that the exempt purposes of the organization are being carried out as intended.

Many organizations are involved in deploying their own personnel overseas to conduct the organization's own mission. In such circumstances, supervisory roles exist and there are not often language and cultural barriers impeding communication and reporting expectations. It is in cases where an organization considers supporting personnel or projects with which it has no organizational ties; e.g., an unaffiliated domestic or foreign organization, that the organization must first review the unrelated project or work to determine that it is consistent with its own exempt purposes. If so, the organization must establish policies and procedures for reviewing progress, accounting for expenditures, and doing appropriate audits. Evidence that such policies exist and are implemented must be presented to ECFA.

Standard No. 5: "Every member organization shall provide a copy of its current audited financial statements upon written request."

Standard No. 5 is the one that specifically deals with financial disclosure. At the core of ECFA's purpose is its commitment to appropriate public disclosure. An up-front, confident provision of financial information upon written request enhances a nonprofit's credibility before the public.

Specifically, ECFA supports (and enforces when necessary) disclosure of the Form 990 in accordance with federal law. In addition, ECFA requires its members to send a complete copy of its most recent audited financial statements to anyone making a request in writing. The audit should be available in a timely manner from the close of the organization's fiscal year. ECFA allows between 4 to 7 months from its members' respective fiscal year ends to supply an audit for that fiscal year.

ECFA does not require its members to provide public disclosure of specific salary information beyond that which is reported in the 990. However, such disclosure is encouraged by ECFA. The basic premise behind ECFA's disclosure requirements and additional disclosure recommendations is full transparency before the public which in turn increases public confidence. The numbers revealed in financial statements are not always so important to the donor public as much as the fact that they are disclosed in the first place.

ECFA has on occasion received complaints about member organizations which have been hesitant or even unwilling to provide a copy of the audited financial statement upon written request. Many organizations fear that the information will be misinterpreted and used against them. In such cases, ECFA intervenes, and reminds members that financial disclosure is required regardless of who is asking or for what purpose they are asking. The member in question is asked to provide the audit to the inquirer within a set period of time (usually two weeks from receipt of ECFA's letter) with a copy of their response sent to ECFA. In every case that ECFA has been required to enforce this standard, the member in question promptly complied in order to protect its membership in ECFA.

Related to the issue of disclosure is the concern over fair representations of allocations of costs. The assumption that one ministry reporting that it spends 95 cents of every dollar on program services is necessarily more efficient than another ministry reflecting only 70 cents for every dollar expended on program services is a myth. There are no standardized reporting requirements for allocating costs into categories of fund raising, general and administrative, and program services expenses, either from the IRS or the accounting profession. Organizations may determine cost allocations in a variety of different ways. ECFA has steered clear of assessing a member's effectiveness or efficiency based on percentages of such costs. This is largely due to the many variables affecting such reporting. Newer organizations in their cash poor formative years are necessarily going to incur greater overhead costs in the startup of their work. It does not necessarily reflect inefficiency. Too often donors and other users of financial information fail to make an apples to apples comparison of how various costs are allocated.

ECFA is following the efforts of the Financial Accounting Standards Board (FASB) related to uniform accounting procedures for nonprofits. It is not an issue without controversy, so no immediate determinations are expected. In addition, ECFA is keeping aware of the efforts of the Association of Evangelical Relief & Development Organizations (AERDO) on the subject of recording and accounting for gifts-in-kind; another issue that affects nonprofit accounting and impressions left by a review of nonprofit financial reports. AERDO Standards require that gifts-in-kind be recorded at wholesale or less, while many charities will record such gifts at retail, and some charities at inflated values.

Standard No. 6: "Every member organization shall avoid conflicts of interest. Transactions with related parties may be undertaken only if all of the following are observed; 1) a material transaction is fully disclosed in the audited financial statements of the organization; 2) the related party is excluded from the discussion and approval of such transaction; 3) a competitive bid or comparable valuation exists; and 4) the organization's board has acted upon and demonstrated that the transaction is in the best interest of the member organization."

The intent of this Standard is to provide additional assurance to donors and other supporters that financial transactions are conducted fairly and are in the best

interests of the organization. It is also intended to provide for a more impartial environment which will support fairness in decision making. A conflict of interest can arise when a donor, board member or other influential person tries to conduct business with the organization in such a way as to gain some personal benefit. This can range from trying to "pass-through" gifts to individuals while obtaining a tax receipt, to promising future gifts if the organization conducts business with an individual or their company. All conflicts of interest are related party transactions. Not all related party transactions are conflicts of interest. It is the goal of Standard No. 6 to assist members in maintaining ethical business practices and require certain documentation which substantiates the veracity of any related party transactions.

Conflicts of interest/related parties means yourself, your spouse, family members, business interests, and/or associates. Conflicts of interest may arise when one party has the ability to significantly influence the management or operations of the other, to the extent that one of the transacting parties might be prevented from fully pursuing the interests of the nonprofit organization rather than his/her own separate or related party interests.

Not only has ECFA required its members to demonstrate that any related party transactions are indeed in the best interests of the organization and conducted in verified "arms length" agreements, but also ECFA has begun to encourage its members to develop and implement a conflicts of interest policy.

Standard No. 7: "Every member organization shall comply with each of the ECFA standards for Fund Raising."

- 7.1 *"All representations of fact, description of financial condition of the organization, or narrative about the events must be current, complete and accurate. References to past activities or events must be appropriately dated. There must be no material omissions or exaggerations of fact or use of misleading photographs or any other communication which would lead tend to create a false impression or misunderstanding."*
- 7.2 *"Fund raising appeals must not create unrealistic donor expectations of what a donor's gift will actually accomplish within the limits of the organization's ministry."*

- 7.3 *"All statements made by the organization in its fund raising appeals about the use of the gift must be honored by the organization. The donor's intent is related to both what was communicated in the appeal and to any donor instructions accompanying the gift. The organization should be aware that communications made in fund raising appeals may create a legally binding restriction."*
- 7.4 *"An organization raising or receiving funds for programs that are not a part of its present or prospective ministry, but are proper in accordance with its exempt purpose, must either treat them as restricted funds or channel them through an organization that can carry out the donor's intent, or return the funds to the donor."*
- 7.5 *"Organizations making fund raising appeals which, in exchange for a contribution, offer premiums or incentives (the value of which is not insubstantial, but which is significant in relation to the amount of the donation) must advise the donor of the fair market value of the premium or incentive and that the value is not deductible for tax purposes."*
- 7.6 *"On request, an organization must provide a report, including financial information, on the project for which it is soliciting gifts."*
- 7.7 *"Compensation of outside fund raising consultants based directly or indirectly on a percentage of what is raised, or on any other contingency agreement, may create potential conflicts and opportunities for abuse. Full disclosure of such agreements is required, at least annually, in the organization's audited financial statements, in which the disclosure must match income and related expenses. Compensation to the organization's own employees on a percentage basis or a contingency basis is not allowed."*
- 7.8 *"Tax deductible gifts may not be used to pass money or benefits to any named individual for personal use."*
- 7.9 *"An officer, director, or other principal of the organization must not receive royalties for any product that is used for fund raising or promotional purposes by his/her own organization."*
- 7.10 *"Property or gifts in kind received by an organization, should be acknowledged describing the property or gift accurately without a statement of the gift's market value. It is the responsibility of the donor to determine the fair market value of the property for tax purposes. But the organization should inform the donor of IRS' reporting requirements for all gifts in excess of \$5,000."*

- 7.11 *"An organization must make every effort to avoid accepting a gift from or entering into a contract with a prospective donor which would knowingly place a hardship on the donor, or place the donor's future well-being in jeopardy."*
- 7.12 *"The representative of the organization, when dealing with persons regarding commitments on major estate assets, must seek to guide and advise donors so they have adequately considered the broad interests of the family and the various ministries they are currently supporting before they make a final decision. Donors should be encouraged to use the services of their attorneys, accountants, or other professional advisors."*

ECFA reviews samples of each member organization's fund raising appeals, as well as the receipting device, to ensure compliance with the Fund Raising Standards. Several of the Standards 7.1 through 7.12 (those Standards related to fund raising) come directly from IRS regulations and charitable solicitation laws. For example, ECFA has paid close attention to its members that use premiums and incentives in their fund raising appeals to ensure that they reflect the fair market value of items given in exchange for a donation, and inform donors that that value is not tax-deductible.

Having described the purpose, Standards, frequently encountered issues among members, and procedures of ECFA; and having expanded on some of the issues that have been of greatest concern to ECFA, I will now respond to the eleven items delineated in paragraph four of your June 3 letter.

- 1) **990 Information:** Information currently available in independently audited financial statements that is not reflected in the Form 990 is primarily in the form of disclosures contained in the notes to the financial statements. The notes are often the most meaningful and informative part of the financial statements. The most significant items are details about the nature of the organization and its activities, as well as additional disclosures concerning financial and related party transactions which might be items that could be incorporated into the 990. The 990 includes information about most significant issues and elements. We would suggest adding to the 990 a section that explicitly states the organization's IRS approved "exempt purposes," so that reference could be made to current activities and expenditures.

- 2) 990 Accuracy: In order to improve the information on and accuracy of the Form 990, we believe that preparers must be better trained on the nature of the information that is being requested and that they must also take seriously the need to provide accurate and informative information. We would suggest that the IRS make a special effort to provide further training and information to assist organizations and the individuals involved in preparing the 990 form accurately. This should be directed at both understanding the form as well as the underlying principles and issues. The 990 information is comprehensive and complex to the average nonprofit volunteer or employee. The complexity of underlying principles and issues as well as the significant information gathering required to complete the form provide for a high potential for inaccuracies or lack of complete information. I would also suggest more interaction with organizations when it appears that the forms have not been properly completed. Because the form does not produce a tax remittance, it appears that the IRS does not pay close attention to the forms unless or until an organization is being looked at more closely. Perhaps a compliance review could be made of selected returns that would initiate questions on more obvious errors and omissions. This should serve the purpose of making constituents aware that the form is taken seriously and paid attention to by the IRS.

- 3) Results of ECFA Field Reviews: The addition of ECFA's Field Review program in 1989 to the scope of ECFA's mission has greatly increased its ability to verify compliance among members. We have opportunity to meet with senior staff and board members, and review a greater volume of documentation not submitted with the original application form or the annual membership review form.

The greatest results from the Field Reviews are educational--increased knowledge and adherence to ECFA Standards, IRS regulations, etc. Unless some egregious violations are unearthed, the field review program is not intended to lead to punitive action against members. The primary purposes of the field review are as follows:

- To confirm compliance with the ECFA Standards for membership.

- To verify information submitted by the member organization in its Annual Membership Review
- To identify areas of possible noncompliance with the ECFA Standards for membership.
- To give support to the member organization in moving toward full compliance with the spirit and intent of the ECFA Standards for membership.

Upon completion of over 100 field reviews since 1989, ECFA has increased the knowledge among members of ECFA requirements and IRS regulations which affect them. ECFA has also succeeded in developing stronger relationships with the boards of its member organizations. As stated before, working with nonprofit boards towards excellence and understanding of their legal responsibilities will result in greater care and ability by those boards to abide by all pertinent regulations.

ECFA performs Field Reviews on approximately 6% of its over 720 member organizations annually. Since members are selected randomly for review, the awareness that ECFA may choose their particular organization for an on-site review makes each organization that much more careful to continually abide by the Standards.

- 4) Most Frequently Encountered Violations of ECFA Standards: In submitting Annual Membership Reviews, several members struggle with submitting the required audited financial statements in a timely manner. When members are terminated for failure to comply with one or more of the ECFA Standards, it is more often than not due to a failure to supply the required audit. We have established a policy whereby organizations can gain an extension to submit the audit if appropriate documentation is supplied from the organization's auditors and audit review committee indicating the reasons for the delay of the audit.

In the course of Field Reviews, ECFA representatives frequently discover that though the member organization has an Audit Review Committee on paper, it is often not functioning. In these cases, organizations are provided with a Commentary on ECFA Standard No. 2 which delineates the specific

responsibilities of the audit review committee. The organization is asked to inform ECFA of its progress in abiding by this section of Standard No. 2.

There are some boards of ECFA members that are in effect "rubber stamps" for agendas of the CEO or the Chairman of the Board. Rarely has ECFA encountered any malfeasance in these situations among members, but yet the potential exists. ECFA is committed to strengthening the accountability relationship between senior management, the board, and the donor public, and therefore will provide motivation for the boards of these organizations to be in keeping with the spirit and intent of ECFA Standard No. 2 rather than just an appearance of compliance on paper.

On occasion, during Field Reviews, members are advised to seek professional counsel to determine whether they may be subject to UBIT, or if reporting of housing allowances is handled appropriately.

- 5) Board Meeting Attendance and Voting: Every ECFA member is required to attest annually that their board met at least twice in the last year and that the majority of those in attendance and voting were non-family/non-staff board members. This is reported on the Annual Membership Review form, which requires the signature of the CEO, the Chief Financial Officer, and the Chairperson of the Board. In the event that the Chairperson of the Board is a staff person, some other non-salaried Board Officer may sign. These signatures are affirming that all information given in the Annual Membership Review fully and fairly describes the financial reporting, disclosure, and administrative practices of the member organization.

When an organization is chosen for a Field Review, board minutes are reviewed. The board minutes will bear the date of the meeting and the names of those present. This further assures that independent governance of the organization is in practice and not simply on paper.

One related comment, ECFA reviews the bylaws of all its member organizations to confirm that an independent board is the ultimate governing authority. In other words, we look for any loopholes or caveat statements in the bylaws which could allow one person veto power, or authority to

"fire" the board. Finding such verbiage in bylaws could preclude compliance with Standard No. 2.

- 6) Standards Committee Efforts Re: Compensation: No final recommendations to the ECFA Board have come from the ECFA Standards Committee to date which would establish standards for establishing reasonable compensation. The ECFA application form and Annual Membership Review forms ask for compensation information of the five highest paid employees of the organization. The following is reported to ECFA in dollar amounts: current annual salary, royalties and/or bonuses, other fringe benefits (including such things as hospitalization, life insurance premiums, housing or car allowances, tuition payments, etc.), expense account. All these figures are added together to reflect total compensation. The Standards Committee is currently working on a recommendation to establish guidelines and perhaps standards for determining reasonable compensation among ECFA members. We would be pleased to report the recommendations to the Subcommittee on Oversight of the House Ways and Means Committee once they are determined by the Standards Committee and approved by the ECFA Board.

Current ECFA activities in this area are directed at assisting members in establishing fair compensation levels. We are aware of the general guidelines offered by the IRS, including asking such questions as "Who determines the compensation?" or "Are there control measures in place?" and "Is compensation commensurate with duties?" We have advised members of the "three likes" test in IRC Section 162, where reasonable compensation is generally defined as that amount that "would ordinarily be paid for like services by like enterprises under like circumstances."

In addition to reviewing compensation information of ECFA members, and looking for "standout" examples of compensation which might be deemed unreasonable (in which cases, though very rare among ECFA members, further justification and substantiation for compensation levels are requested by ECFA), ECFA has encouraged its members to follow these additional guidelines in determining and monitoring compensation levels:

- Establish a Board subcommittee specifically for compensation review.
- Gather information in accordance with the "three likes" test.
- Consider ALL elements of compensation (both taxable and untaxable).
- Record Board approval of CEO compensation package in the formal board minutes.

- 7) Related Party Transactions: In considering what types of related party transactions have raised the potential for a conflict of interest, I would respond simply that ANY related party transaction has the potential for a conflict of interest if not properly managed and disclosed. There are many cases where an organization will benefit or save money or otherwise have its effectiveness enhanced by related party transactions. The problem comes when the related party has undue influence over the board or the management in conducting the transaction.
- 8) 990 Disclosures: We think it is important that the 990 form identify all related entities, as well as transactions with related parties, including related not-for-profit and for-profit organizations, from which employees, officers, directors, and their related parties may receive compensation or other financial interest. The information should lead a reader to be able to tie together other organizations whereby an individual or related party might receive financial benefit or multiple compensation arrangements. Of particular concern would be business entities that contract and do business with an organization with which board members and employees or their related parties have an ownership or other financial interest.

Schedule A, Part III, Question 2 of the 990 asks for disclosure of transactions with individuals and taxable entities, but NOT all related parties. Schedule A, Part VII deals with non-charitable exempt organizations and tax-exempt organizations other than those described in Section 501(c)(3) of the Internal Revenue Code. We would suggest that ALL the above be consolidated under the area of related entities and related party transactions for clarity--also that transactions with other related 501(c)(3) organizations be identified. We would reference for your

information an exposure draft dated May 19, 1993 by the American Institute of Certified Public Accountants (AICPA) entitled, "Reporting of Related Entities by Not-for-profit Organizations." This document proposes new standards and includes reference to FASB No. 57 concerning related party transactions.

- 9) Lawsuits/Investigations/IRS Audit: ECFA requires its members to reveal, in the information submitted for Annual Membership Review, the nature of any lawsuits in which they are involved and the expected outcome. They are usually of limited scope and treated with confidentiality. ECFA makes no recommendation on the public disclosure of lawsuits. If ECFA were to make such a recommendation, it would be largely dependent on the nature of the lawsuit and its relevance to ECFA Standards or its potential to threaten the viability of the organization or its continued tax-exempt status. To date ECFA has not encountered such lawsuits among its membership. During Field Reviews, ECFA representatives will review (with the organization's legal counsel present, if desired by the organization) legal documents pertaining to any lawsuits.

ECFA also asks if the organization has ever been audited by the IRS and if so, what the findings and determination were. Many times we find that members have been audited by the IRS but have not yet received the results of the audit. In such cases ECFA will follow up with the organization until the audit results are available to ensure that the organization continues its IRS status. ECFA has not encountered an ECFA member which has been audited by the IRS where there was a negative outcome. A negative IRS audit determination could lead ECFA to suspend or terminate membership privileges.

- 10) Suggestions to Donors for Greater Assurance: Even with the best efforts of the IRS, ECFA, NCIB and BBB, there are no absolute guarantees that all charitable gifts will be used at all times, both nationally and internationally, for the stated exempt purposes. Nevertheless, it is ECFA's firm belief that an informed donor is the best friend of nonprofit organizations. Instilling confidence in donors should be a priority for nonprofits. In turn, donors need to ask questions and demand adequate answers before giving. If

donors do not receive satisfactory responses, they should not give. There are plenty of worthy organizations which take seriously the commitment of accountability to the donor public that are prepared to give the assurance to donors that they deserve.

ECFA provides a Giver's Guide, which includes a "Donor's Bill of Rights," which encourages donors to recognize their right to:

- Know how the funds of an organization are being spent.
- Know what the programs they support are accomplishing.
- Know that the organization is in compliance with federal, state, and municipal laws.
- Restrict or designate gifts to a particular project.
- A response to inquiries about finances and programs.
- Visit offices and program sites on an organization to talk personally with the staff.
- Not be highly pressured into giving to any organization.
- Know that the organization is well managed.
- Know that there is a responsible governing board and who those board members are.
- Know that all appeals for funds are truthful and accurate.

NCIB also provides a "Wise Giving Guide" which reports on certain charitable organizations and measures their compliance with NCIB standards. The Philanthropic Advisory Service of the BBB provides a publication entitled, "Give but Give Wisely."

A recent publication entitled, "Special Report: How to Protect Your Charity Donations from Fraud," by Rev. Joel MacCollam, President of World Emergency Relief, gives several specific suggestions for things that donors can do to gain confidence when making charitable contributions. They include the following:

- Ask questions. Legitimate charities will answer legitimate questions.
- Make checks payable to the charity, and not to the individual asking for the donation.

- Check charities out with one of the various monitoring groups (e.g. ECFA, BBB, or NCIB)
- Learn to read a charity's (or ministry's) audited financial statements.
- Visit the charity.
- Be sure the charity/ministry is properly registered with government agencies.
- Check local authorities for any complaints about a particular organization.
- Ask for a copy of the organization's IRS "determination letter."
- Get references.
- Be sure the charity will show you its IRS Form 990 filings for the past three years.

- 11) Public Disclosure of 990: ECFA, and other organizations in the evangelical community, have consistently, through training, made organizations aware of the public disclosure requirements of the law. We do not have specific information on compliance with that law, but also do not have complaints or other information to indicate that there is not compliance with the law. We believe that there are relatively few individuals who request such information from organizations. We have noted that it is also true that donors rarely request independently audited financial statements that are made available to the public. This may speak to the need for donors to become more interested in understanding and asking questions about the organizations that they support.

I do know that in the course of ECFA Field Reviews, ECFA representatives have discovered that most, if not all, of the members reviewed had a file with the three most recently filed 990s available on site for public inspection. I do not recall any of the organizations having been asked by any interested party to review the file.

Comments on Proposed Legislation:

Concerning the proposed legislation, we believe that the 5% excise tax proposed to be levied upon organizations and individuals engaged in acts of private inurement, private benefit, self-dealing, and unreasonable compensation, would put a degree of seriousness and concern upon the managers of organizations to be sure

they are within safe harbors in their actions. We would suggest that the IRS provide information to inform the public about what these are. We do not believe there is at present good understanding about what constitutes private inurement and benefit or self-dealing, either among donors or the organizations themselves.

Concerning the proposed concept of granting tax exemption for limited periods of time, we do not feel that this is a workable proposal. I believe that it will be difficult to administer and would be very significantly unfair to organizations that need to establish long-term donor relationships and ongoing programs which might be jeopardized, inhibited, or severely damaged if there is not the ability to continue those programs in perpetuity as the need continues.

I am not sure I fully understand the phrase dealing with the additional section in which an organization would need to report the payment of additional taxes for self-dealing, prohibited political activity, excessive lobbying, and unrelated business income, but it would appear to encourage reasonable disclosure. I am also not sure what additional public access to Form 990 the Committee is considering.

Currently, nonprofit organizations are required to have copies of the three most recent years of Form 990 filed with the IRS available on-site for public inspection. It is my understanding that some consideration is being made to require that nonprofits be willing (as some are already doing) to supply copies of their recent 990 forms by mail to those who would request it (with allowance to charge reasonable amounts for duplication and postage). ECFA would not be opposed to such a requirement, and would participate in educating its members of such regulations if indeed they are made law.

In conclusion, I would like to reiterate ECFA's firm belief that extensive additional legislation targeting all nonprofits (in response to the misdeeds of a very few) may be overkill and indeed could mean the end of many worthy charitable causes. Fine tuning or enhancing the 990 form to gain more meaningful information may be in order. But even more in order are efforts to educate nonprofits and assist them in meeting existing IRS requirements. Nonprofits are currently faced with the possibility of massive postal rate increases; have been asked to bear greater responsibilities in addressing social, spiritual, physical and

economic needs of society (with ever dwindling government funding), and adhere to strict state solicitation laws that are static at best. Problems of excessive compensation, deceptive fund raising, conflicts of interest, self-dealing, etc. are in the clear MINORITY of nonprofit organizations. More concentration needs to be made towards empowering nonprofits to operate fully within the bounds of current law, with all the tools necessary to carry out their programs most effectively.

Thank you for allowing me to testify at the upcoming hearing. ECFA is eager to answer any questions you may have.

Sincerely,

Thomas E. McCabe
Chairman

cc: ECFA Board of Directors
Mr. Clarence Reimer
Mr. Gregg Capin

Chairman PICKLE. Mr. Reimer, do you have an additional statement? I thank all three of you for your testimony.

Obviously, you are involved in the area of standards that organizations should adhere to, furnishing information to the agencies, to organizations and helping them maintain the ability to do the right kind of a job. I don't know what we would do without your organizations, because these organizations need to meet certain standards, whether we agree with all of them or not. So it is commendable and very helpful.

We have submitted questions to you and you have responded to us and we are going to submit additional questions to you.

I am advised that we are going to have some votes immediately on the floor, so I may be submitting additional questions to you for your answer.

[No questions were submitted.]

Chairman PICKLE. I am a little concerned that you seem to think that if we have some legislation that it would be overkill. I believe that is what you said Mr. McCabe.

What specifically would be overkill if we try to get some control over this fast growing part of the economy, by far the biggest growth sector in the entire economy?

Mr. McCABE. I believe one or two possible areas would be to identify the setting of limits on compensation. We believe strongly that this really is a combination of a board matter and a public disclosure matter and that as the donors and the supporters of organizations are aware of this kind of information, they will be allowed to make their own choices in that regard.

Chairman PICKLE. Board members should have the responsibility of setting the wages or the salary. But, when you have salaries of \$1 million, do you think that is acceptable for a charity?

Mr. McCABE. I think it is quite unusual, to say the least.

Chairman PICKLE. \$500,000? For a charity? There is a limit, of course, and it is very difficult for us to try to talk in terms of limiting salaries, so I will agree that it is not an easy matter.

The Commissioner testified that limits would be a problem and we accept that. But I think the public would be generally shocked to know that these charities are getting that kind of a salary level of pay. That is a matter I think we have to consider.

I think we all think we can improve the 990, we can get more information, if we have more sunshine. I think we can make improvements in the field. I don't know whether we can get approval for you to review sanctions. Two of you said you have serious questions about the interim sanctions, the 5 percent or whatever percent, and you were against that.

Mr. Albrecht was against it, I believe. Mr. McCabe was against it, and I don't know whether you touched on it or not.

Mr. WEINER. As far as the excise tax and the sunset suggestion, the Council of Better Business Bureaus does not normally take positions on legislation or areas of penalties for future or existing rules. It is beyond our purview, so to speak.

Chairman PICKLE. That is all right. I am not asking you to take a position on it.

I don't know that we put that in our questionnaire. We are trying to give IRS a vehicle to carry out the policies intended under

501(c)(3), and I think we have to consider different approaches. I would like to hope that your organizations would, with the help of the Lord, make these organizations do what is right. Short of that, we are still in the real world and we are trying to find out a better way to do it.

But I am pleased that you weren't here in opposition to doing anything. You think we ought to be cautious about it. We certainly don't want overkill and don't want to cause a lack of giving to charitable organizations because, by and large, they do a lot of good.

I want to thank you. I think that your organizations are the kind that allow the charities to talk to each other and to know what is right and what is proper and adhere to certain standards. So you render us a very good service.

I have had some experience with some of the so-called watchdog organizations and it hasn't been altogether pleasant. I hope we have a pleasant relationship.

We want to cut out the abuses and make the program work. If we don't, it will blow up on us.

We have a vote on the floor so I am not going to ask other questions.

Mr. Kleczka, do you have any questions?

Mr. KLECZKA. A couple of brief ones. Mr. McCabe, your organization is a voluntary organization joined by nonprofit Christian ministries; is that correct?

Mr. MCCABE. That is correct.

Mr. KLECZKA. How many ministries have joined your organization and what is the total universe of the Christian ministries?

Mr. MCCABE. Slightly over 720 have joined the organization and it would be hard to put a number on the total number that might be prospective members.

Mr. KLECZKA. I am assuming filers of the——

Mr. MCCABE. There would be 728 nonprofit members.

Mr. KLECZKA. That is how many joined your organization. Out of how many total Christian ministries are nonprofit?

Mr. MCCABE. I am not sure what that number would be.

Mr. KLECZKA. I assume we could get that from IRS. I am wondering if it is half or more than half of those out there.

Mr. MCCABE. Some have suggested that we might be in the range of 20 to 25 percent, but I am not certain of that.

Mr. KLECZKA. Mr. Albrecht, you indicate your organization is also voluntary; correct?

Mr. ALBRECHT. Yes, it is.

Mr. KLECZKA. How many nonprofits are members of your organization?

Mr. ALBRECHT. They are not members, Congressman. We select the organizations that we want to get information from; and they, as with Better Business Bureau, may or may not send it to us.

Mr. KLECZKA. So if I were a nonprofit, I could then join the organization and then tell the people who I am soliciting that I am a member of the National Charities Information Bureau?

Mr. ALBRECHT. Not a member. But if they do meet our standards, we have no objection to their saying they meet our standards.

Mr. KLECZKA. So you have, for lack of a better word, given "accreditation" to how many charities?

Mr. ALBRECHT. I said we have reports that around 250 at the moment. And about 77 percent of those meet all our standards.

Mr. KLECZKA. Of the 250?

Mr. ALBRECHT. Out of 250.

Mr. KLECZKA. The same question as I asked Mr. McCabe: How many total charities, in round figures?

Mr. ALBRECHT. The figure the Commissioner used today was 300,000 or 400,000. So it is very insignificant. But it also happens to cover some of the larger charities. So the income of those charities that we do report on constitutes about 10 percent of the nonreligious giving in 1992.

Mr. KLECZKA. OK. And the last question of Mr. Weiner.

You indicated that compliance, due to your requests, are running about 90-percent nationwide for all the Better Business Bureaus.

Mr. WEINER. In terms of disclosure of information to our office. To the council.

Mr. KLECZKA. Once requested?

Mr. WEINER. Once requested, 90 percent.

In terms of compliance with our standards, roughly one out of every four shows not meeting one or more of the guidelines.

About 23 percent don't meet standards of the ones we review.

Mr. KLECZKA. I am surprised. You are getting a 90-percent response, which is not bad.

Mr. WEINER. Yes.

Mr. KLECZKA. OK. Thank you, Mr. Chairman.

Chairman PICKLE. The Chair wants to say again that we have a few copies of this "Warehouses of Wealth," the publication of the Philadelphia Inquirer, if you want a copy. We have a few left up here.

I appreciate your testimony, and we will be in touch with you later.

The committee is adjourned.

[Whereupon, at 4:30 p.m., the hearing was adjourned, to reconvene on Monday, August 2, 1993.]

REVIEW OF FEDERAL TAX LAWS APPLICABLE TO PUBLIC CHARITIES

MONDAY, AUGUST 2, 1993

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, D.C.

The subcommittee met, pursuant to call, at 1:32 p.m., in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

Chairman PICKLE. The subcommittee will please come to order. I have an opening statement and then Mr. Houghton has an opening statement.

At the conclusion of those two statements, unless others have statements they wish to make, we will make a motion to go into executive session and we will proceed on that basis.

Today the Subcommittee on Oversight is holding its second hearing to review the activities of public charities exempt from Federal taxation under section 501(c)(3) of the Internal Revenue Code. At today's hearing, we will focus on the enforcement activities of the Internal Revenue Service. In addition, we will receive testimony from the attorney general of Connecticut and I will make additional remarks for the attorney general of Texas.

Lastly, we will examine the adequacy of current reporting and public disclosure requirements, particularly on form 990.

Before the public testimony, the subcommittee will go into closed executive session to receive nondisclosable testimony from the IRS field agents about IRS enforcement activities. Following the closed session at approximately 3 p.m. or earlier, the subcommittee will resume the public part of the hearing.

Over the past year, the subcommittee has received information from the public, including insiders at several charitable organizations, about questionable activities at some of our public charities. In addition, the subcommittee staff has interviewed IRS officials and auditors nationwide about abusive practices engaged in by some charities. We have learned of the following examples where charities used charitable assets for personal gain. I am going to list two or three of these items. For example, one, with the assets from one charitable organization, an executive paid his child's college tuition, leased a luxury car for his wife, had his kitchen remodeled, and rented a vacation house at the beach. The charity permitted him to charge almost \$60,000 in personal expenses to the organization's credit card.

Second, at a tax-exempt hospital, the CEO used charitable assets to pay for such personal items as liquor, china, crystal, perfume, airplane and theater tickets. The hospital also picked up the tab for the CEO's country club charges and catered lunches to the tune of approximately \$20,000.

Third, another charity paid \$200,000 for its executive director's wedding reception and tropical island honeymoon. The charity also plunked down \$90,000 as a downpayment for the director's home and had enough left over to pay for his trip to a health spa.

Admittedly, these examples of abuse do not represent what is occurring in all public charities. I believe that the vast majority of charities serve an invaluable public purpose. These examples I have just given, however, do illustrate that charities are not immune from abuse by executives more interested in lining their own pockets than in serving the public. Moreover, the contributors may never learn exactly how their donations are being spent by such charities. Many of the abuses I have just cited were not reflected on the form 990 filed by the charity with the Internal Revenue Service.

Now, at the subcommittee's first hearing on charitable organizations, we learned that the Internal Revenue Service literally is overwhelmed and can neither identify nor sanction charitable organizations or their executives who abuse the public trust by diverting charitable assets for private purposes. Little, if anything, is being done to address these abuses. At best, Federal and State enforcement efforts have been limited.

The Subcommittee on Oversight is holding this hearing because we believe the public has a right to have confidence that charities nationwide are spending their tax deductible contributions in a worthwhile manner. I believe change is needed and is long overdue. Internal Revenue Service must have the tools to deter and punish inurement and private benefit and the public must have access to information sufficient to make informed judgments about their charitable giving.

I will ask the subcommittee to continue to work with the Treasury, IRS, and others to develop timely and meaningful reforms to address the issues of abuse and accountability. The credibility and the integrity of the entire charitable community is at stake.

My goal is to insure that their valuable activities are not tarnished by the bad acts of a few. At some time in the hearing, toward the end, we may make more specific recommendations that we might or might not follow.

Now that completes my statement, and I ask Mr. Houghton to make any opening statement he cares to.

Mr. HOUGHTON. Thank you, Mr. Chairman, ladies and gentlemen, and it's good to see you here today.

I am pleased to join in the opening of the second hearing on tax-exempt organizations. The first hearing on June 15 gave us an overview of the compliance issues affecting public charities.

Most charities, as you know, obey both the letter of the law and the spirit of the law, however, there are some charities that obey neither. And the executives of some of these charities live by the motto that "charity begins at home." They take good care of themselves before they help others.

No one expects these people to operate like paupers, yet at the same time they should not operate like princes either. Charities are just that, charities. The purpose of today's hearing is to explore the details of some real cases which illustrate the abuses which are occurring.

We will hear from the working level IRS agents who actually audit the charities. Their firsthand experience obviously is going to be very helpful to us. Once we have a good understanding of the pattern of abuses, we will be in a position to develop an appropriate legislative response. Let me repeat, this is not a witch hunt.

In June, Commissioner Richardson testified that the IRS was willing to work with us to address any of the problems which exist. I trust that working together we are going to be able to develop a balanced set of recommendations. I look forward to receiving today's testimony.

I yield the remaining part of my time, Mr. Chairman.

Chairman PICKLE. Do any other members have an opening statement?

The Subcommittee on Oversight will now go into closed session to review tax information from the Internal Revenue Service. This information is subject to strict rules of confidentiality imposed by statute in the Internal Revenue Code section 6103.

This information cannot be disclosed in public to persons not authorized by statute. Now, as I said earlier, the subcommittee will resume its hearing in approximately an hour from now, or before 3 p.m. to receive publicly disclosable statements from the IRS that you have out before you now.

Now, I am going to recognize Mr. Jefferson to make the proper motion. I believe we have enough members to have a quorum.

So Mr. Jefferson, would you like to make your motion now?

Mr. JEFFERSON. Thank you, Mr. Chairman.

I move that the subcommittee go into closed session in order to receive tax information as required by the Internal Revenue Code, section 6103 and the committee rules.

Chairman PICKLE. There must be a rollcall vote on this issue. Those in favor will say aye when their names are called. Will the clerk call the roll?

The CLERK. Mr. Jefferson.

Mr. JEFFERSON. Aye.

The CLERK. Mr. Brewster.

Mr. BREWSTER. Aye.

The CLERK. Mr. Kleczka.

Mr. KLECZKA. Aye.

The CLERK. Mr. Lewis.

[No response.]

The CLERK. Mr. Houghton.

Mr. HOUGHTON. Aye.

The CLERK. Mr. Herger.

Mr. HERGER. Aye.

The CLERK. Mr. Hancock.

Mr. HANCOCK. Aye.

The CLERK. Chairman Pickle.

Chairman PICKLE. Aye.

The CLERK. Mr. Chairman, the ayes have it.

Chairman PICKLE. At this point, the Chair does find that they have it and only subcommittee members, authorized committee staff, Joint Committee staff and representatives of the IRS are permitted to remain in the hearing room.

I therefore ask that everyone else in the room quickly leave the room without delay so we can proceed. I will ask that the staff move to the back of the room to see if all people not authorized will be leaving the committee room.

If you do it quickly, we will be back in session again in short order.

[Whereupon, at 1:40 p.m., the subcommittee proceeded in executive session.]

Chairman PICKLE. The subcommittee will come to order again.

We appreciate the public's indulgence, but we felt it was important to have an informal private session with the field agents involved. Now, we are going to have testimony that touches upon many of these cases we have been discussing, and our first witness to make this analysis will be Marcus Owens.

He is Director of the Exempt Organizations Technical Division, and Mr. Owens is on my right. He will be accompanied by Howard Schoenfeld, who is Special Assistant for the Exempt Organizations Matters, and has been with us on many occasions over the years.

We also have in the audience field representatives from the IRS who have been testifying with the committee in the closed session. They are here, and I don't know whether a question will be directed to them, but I presume that there will if there are appropriate questions. Then, after that, we have the assistant attorney general, David Ormstedt of Connecticut, and I am going to give the analysis of the statement for the attorney general of Texas, Dan Morales.

So we are going to ask, Mr. Owens, to proceed and make a statement with Mr. Schoenfeld or Mr. Sullivan. I don't know what Mr. Sullivan's position is? Are you just accompanying Mr. Owens?

Mr. OWENS. Mr. Sullivan is technical assistant for health care industries in the Office of Associate Chief Counsel, Employee Benefits and Exempt Organizations.

Chairman PICKLE. All right. Fine. We are glad to have you, Mr. Sullivan. Now, Mr. Owens, if you will proceed, and you have your statement. Do all members have a copy of your statement? If you will hold up, Mr. Owens. All right, now, Mr. Owens, if you will proceed.

STATEMENT OF MARCUS S. OWENS, DIRECTOR, EXEMPT ORGANIZATIONS TECHNICAL DIVISION, U.S. INTERNAL REVENUE SERVICE, ACCOMPANIED BY HOWARD M. SCHOENFELD, SPECIAL ASSISTANT FOR EXEMPT ORGANIZATION MATTERS; AND T.J. SULLIVAN, TECHNICAL ASSISTANT FOR HEALTH CARE INDUSTRIES, OFFICE OF ASSOCIATE CHIEF COUNSEL (EMPLOYEE BENEFITS AND EXEMPT ORGANIZATIONS)

Mr. OWENS. Good afternoon. We are glad to have the opportunity to participate in this, the second of a series of hearings reviewing the administration's enforcement of the Federal tax laws applicable to public charities exempt under section 501(c)(3) of the Internal Revenue Code.

As noted when Commissioner Richardson appeared before the subcommittee at its first hearing on this topic on June 15, the Service welcomes your inquiries in this area as they present an opportunity for us to review our compliance programs in this sphere and to share with you our concerns about this important area of tax administration.

Before we begin to address the matters you raised in your request for testimony, including a discussion by Mr. Schoenfeld of hypothetical cases and accompanying form 990s, I would like to respond to your request to briefly summarize some of the cases we described to the subcommittee in the executive session.

Chairman PICKLE. How many of these cases will you be discussing?

Mr. OWENS. We will be discussing eight cases.

Chairman PICKLE. All right, proceed.

Mr. OWENS. One of the cases we presented to the subcommittee involves a section 501(c)(3) organization which provides health care in a clinic type setting. In this case the organization's board of directors is controlled by the CEO and a small number of persons with whom the CEO or the organization itself have substantial business dealings.

The total compensation of the CEO exceeded \$1 million. The compensation package included a base salary, a substantial distribution from an executive compensation plan, and premium payments on several hundred thousand dollars of life insurance.

The organization also made substantial credit card payments and cash disbursements for personal expenditures, including liquor, china, perfume, crystal, theater, and airline tickets.

The organization at one time had substantial assets used in the performance of its charitable purpose. It sold those assets and began purchasing physicians' private medical practices, in many cases at more than fair market value.

The physicians and their staffs became employees of the tax-exempt organization which paid their salaries. The physicians operated out of the same locations, continuing to receive as much income as before the acquisition. The new organization did not provide the requisite community benefit described in Revenue Ruling 69-545.

Issues under consideration include inurement, private benefit, and lack of a charitable purpose. We are also reviewing whether the organization should have reported certain items on its form 990.

A second case we described before the subcommittee involved a large health care institution. In this case, the CEO received extraordinary compensation. The compensation package included a base salary, substantial bonuses, and generous perquisites and fringe benefits.

The organization has an arrangement with its medical staff physicians under which they receive a base salary and a substantial percentage of fees collected with respect to their department without any cap on the amount an individual physician can receive.

The organization also provides housing units for its employees. We are reviewing whether the housing is provided to employees at fair market value. We are also reviewing the deferred compensa-

tion arrangements, as well as the compensation-related issues of inurement and private benefit.

Chairman PICKLE. Now, Mr. Owens, I am interested in knowing some more specific facts about this case and the others. Your statements are rather general in nature.

Can you give us specific sums that are involved? Would that run the risk of disclosing improper information to know what is the offense, if any, and what is the size of the involvement?

Mr. OWENS. In these cases, we are dealing with organizations which had their finances discussed in the press in a number of places and a number of times, and consequently where we have been able to, we use specific dollar amounts. In the first synopsis I gave I did refer to the compensation at \$1 million, but in others, the use of the actual figures would tend to describe the organization with sufficient detail that someone would be able to identify it.

Mr. SCHOENFELD. Mr. Pickle, I would like to add, beyond the disclosure issue that Mr. Owens refers to here, there is also the matter that these are ongoing cases and we would not want to tip our hand by identifying the issues that are, in fact, of particular concern to us.

Chairman PICKLE. I don't think this committee wants to release anything publicly, or disclose publicly that which would interfere with possible prosecution or investigation of an organization.

But I don't know how the public can understand what is really going on when statements are made that are so general without being attached to some additional information. Can you give us a figure, that is, around a certain figure, so that the public can understand what is going on? Not for purposes of identification, but to know what is taking place.

I am just trying to get something that we can tell the public.

Mr. OWENS. In a number of cases, in more than one of these cases, for example, the compensation packages are approaching or exceed \$1 million a year for those in control of the organizations.

Chairman PICKLE. At this point, go ahead with your next case in your testimony, but you can see my concern. I am sure that is shared by the other members, and by the public too.

Mr. HOUGHTON. Mr. Chairman, could I? I believe where you can tie something down without disclosing information you don't want to disclose, it would help us.

Mr. OWENS. I will certainly try to be as open and candid as I can.

Another case that we discussed, we presented to the subcommittee. It involves a section 501(c)(3) organization which provides educational services. In this case, the organization's chief executive officer is provided a significant compensation package, including salary, deferred compensation, expense accounts, and loans, one of which is noninterest bearing.

The CEO is also provided an expensive residence with the organization providing for all related costs of running the residence, including maid service.

The organization also provides, on a regular basis, market rate loans to a class of higher level employees.

Additional issues to be pursued include employment tax and unrelated business income tax.

Chairman PICKLE. Now, here is a case providing educational services. I guess it would be OK to say that is a college or university type organization. Is that correct?

Mr. OWENS. That would certainly be an appropriate kind of organization.

Chairman PICKLE. Now, you say the organization's chief executive is provided a significant compensation package. Can you say what his salary is?

Can you say what is the deferred compensation, how much is the expense account, or how much in loans he has for his residence. Can you do something more than just give me this broad generalization?

Mr. OWENS. We have been advised by our disclosure counsel that the use of the particular figures in this particular discussion would have a fairly high potential for indirect disclosure of the organization's name.

Chairman PICKLE. Well, go ahead with your next case. Your next case that you have got listed here.

Mr. OWENS. This case involves a section 501(c)(3) organization which provides care and service to the poor. In this case, the principal officer of the organization, along with relatives, had control over all aspects of the organization's activities and engaged in numerous acts of inurement.

Organization funds were used to pay for certain personal expenses, such as leasing of vehicles, educational expenses, vacations, home improvements, and rental of resort property. Further, the Service found that the minutes of one of the board of directors' meetings were falsified.

The principal officer and relatives resigned and the board of directors was reconstituted after the Internal Revenue Service audit. The examination resulted in substantial tax and penalties against the officer for unreported income attributable to the value of the items previously cited.

The organization's tax-exempt status was not revoked since they have continued to provide care and service to the poor. No other enforcement actions were taken against the organization.

Another case presented to the subcommittee involves a 501(c)(3) organization which is headed by a televangelist minister. In this case the organization claimed that it was a church and therefore eligible for the benefits of the IRS's church audit procedures.

Organization funds were used to pay for personal expenses, such as an extravagant reception and island vacation, a large downpayment on the televangelist's home, and a second resort vacation. A substantial amount of compensation was not reported on the minister's individual tax return.

Further, a subsidiary charity was engaged in schemes to make it appear that the charitable programs were being accomplished. The IRS found that the organization acquired agricultural supplies for which the sale date had expired and then donated them to another charity claiming a program service activity on its form 990 as providing a benefit to the public in excess of \$1 million.

In one transaction, numerous other intervening exempt organizations were involved in declaring the very same agricultural supplies as in-kind contributions and program service expenditures.

This type of activity would mislead donors into thinking that the organization's charitable work was greater than it actually was and that administrative costs were a smaller percentage of its program costs.

Chairman PICKLE. In this case and others, has there been public discussion in newspapers either in that region or that State? And if so, can that be disclosed?

Mr. OWENS. There have been media discussions of a fair number of these cases, both on a national basis and in the particular regions where they are located, but to discuss the particular coverage would by its very nature disclose the name of the organization.

Chairman PICKLE. Well, that would not prevent an enterprising journalist from matching up some of this testimony that is already publicly disclosed and making his own classification or association, would it?

Mr. OWENS. Indeed, some of the organizations have stated to the press at various times that they are under audit, but the disclosure rules are written in such a way as to preclude the Service from even confirming the accuracy of that statement by the organization.

Chairman PICKLE. All right, go ahead, Mr. Owens.

Mr. OWENS. Another case involves a television ministry. It raises a number of issues of inurement of income to insiders, and misuse of charitable assets for private benefit.

The ministry paid personal expenses for the minister, including a home mortgage and household expenses without board approval. In addition, the ministry paid membership dues to an expensive country club. The ministry purchased additional homes for the minister, designated them as parsonages and paid substantial associated expenses.

The ministry charged substantial expenses to an accounts receivable account for the minister and there have been no repayments by the minister and these expenditures appear to be simply the payment of personal expenses.

In addition, the ministry paid a substantial sum for expenses on a house owned by a member of the minister's family. The house is occupied only a couple of months during the year. Neither the minister nor the family member lived in this house during the rest of the year.

Yet another case presented involves a media evangelist. There have been allegations that the organization raises large sums of money through fraudulent or misleading fundraising. The allegations further point out that although the organization solicits funds for special needs, it is careful to avoid asking for money for a specific purpose.

The allegations also indicate that only a small part of the fundraising is used for charitable purposes.

Data developed provide indications that personal expenses of the officers and controlling individuals are being paid for by the organization. Issues include inurement and private benefit.

The final case that I am going to summarize is a situation involving a number of exempt organizations that contracted with a for-profit fundraising organization. Nearly all of the organizations were viable exempt organizations with ongoing charitable programs.

The exempt organizations were normally approached by the commercial fundraiser to encourage them to use their services as an exclusive provider of fundraising services. The fundraiser owned exclusively or shared an interest in the mailing list created by its efforts. The solicitation material contained a minimal amount of information concerning the exempt organization's charitable program.

Virtually all the money collected was absorbed by fundraiser fees with very little money being available for the exempt organizations' charitable programs. The true cost of the fundraising efforts was not readily discernible from the form 990 since a substantial portion of the costs were allocated to and reported as program services rather than fundraising costs on the premise that the solicitation letters themselves served the dual purpose of fundraising and education.

Chairman PICKLE. Does that complete your statement?

Mr. OWENS. That completes the summary of the discussions we had in the closed session.

[Oral testimony continues on p. 256. The prepared statement and exhibits follow:]

Statement of
 HOWARD M. SCHOENFELD
 SPECIAL ASSISTANT FOR EXEMPT ORGANIZATION MATTERS
 And
 MARCUS S. OWENS
 DIRECTOR, EXEMPT ORGANIZATIONS TECHNICAL DIVISION
 INTERNAL REVENUE SERVICE

Before the
 SUBCOMMITTEE ON OVERSIGHT
 HOUSE COMMITTEE ON WAYS AND MEANS

August 2, 1993

Mr. Chairman and Distinguished Members of the Subcommittee:

Good Afternoon. My name is Marc Owens. With me this afternoon are Howard Schoenfeld and T. J. Sullivan, Technical Assistant (Health Care Industries) in the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations). We are glad to have the opportunity to participate in the second of a series of hearings reviewing the administration and enforcement of the federal tax laws applicable to public charities exempt under section 501(c)(3) of the Internal Revenue Code.

As noted when Commissioner Richardson appeared before the Subcommittee at its first hearing on this topic on June 15, the Service welcomes your inquiries in this area as they present an opportunity for us to review our compliance programs in this sphere and to share with you our concerns about this important area of tax administration.

Before we begin to address the matters you raised in your request for testimony, including a discussion by Mr. Schoenfeld of hypothetical cases and accompanying Form 990s, I would like to respond to your request to briefly summarize some of the cases we described to the Subcommittee in the executive session:

In your letter asking us to appear today, you asked that we discuss the following matters: (1) examples of potential abuses we are reviewing as part of our Coordinated Examination Program (CEP), (2) the 20 cases in the past two years in which we revoked the exemption of an organization on the grounds of inurement or private benefit, (3) the various televangelist cases under review and recently closed, (5) hypothetical cases that illustrate how the IRS analyzes issues involving inurement or private benefit, and (6) the level of compliance by individuals in reporting on Form 1040 any benefits received from public charities, including the findings of a pilot program in Pittsburgh involving physicians.

In response to your request, we have prepared the following materials: (1) a chart, attached as Exhibit A, that shows the issues we have encountered in CEP cases, (2) a chart, attached as Exhibit B, that summarizes the inurement or private benefit issues involved in the 20 cases referred to above, (3) a chart, attached as Exhibit C, that provides details of the issues involved in cases under examination that involve media evangelists, (4) three hypothetical cases, attached as Exhibit D, that present issues of inurement or private benefit and demonstrate our approach to analyzing these issues, together with illustrative Form 990s for the organizations, and (5) a summary of the Pittsburgh information-gathering project, attached as Exhibit E.

The attached materials, consistent with your request, focus on the relatively few cases that raise questions of inurement or private benefit. Although we understand the Subcommittee's interest in learning of the types of problems that we can encounter, we do not want to present a misleading view of the overall level of compliance. Therefore, we would like to

emphasize that the cases described in the attached materials are not representative of public charities as a whole. The hypothetical cases, in particular, are not based on actual cases and are not intended to be representative. We have prepared these cases solely to illustrate our approach to analyzing issues of inurement or private benefit.

And now, Howard Schoenfeld will discuss the hypothetical case examples and accompanying Form 990s.

Although the attached materials do not present an accurate view of the level of compliance by public charities as a whole, they do illustrate the difficulties that the Service can encounter in administering the tax laws applicable to these organizations. We hope these materials are useful to you in conducting your review of the administration of, and compliance with, these laws. Again, we are grateful for the Subcommittee's interest in this area, and we look forward to working with the Subcommittee throughout its review of this area.

COORDINATED EXAMINATION CASE ISSUES

IRC 501(c)(3) Cases Only

June 30, 1993

Total Number of Open Cases		Hospitals/ Healthcare	Colleges & Universities	Media Evangelists	Other 501(c)(3) Organizations
		28	11	7	6
Issues Being Developed:		Number of Cases with Issue			
• Inurement		8	—	5	3
• Private Benefit		9	5	2	—
• Non-exempt Activities		7	—	2	1
• Adequacy of Community Benefit		1	N/A	N/A	N/A
• Unrelated Trade or Business Activity		12	10	4	2
• Employment Taxes		9	7	5	4

TWENTY (20) REVOCATION CASES **1991-1992**

Issue: Inurement/Private Benefit

	Number of Cases with Issue
• Unreasonable Compensation	3
• Unreasonable Fringe Benefits	1
• Use of EO's Assets	13
• Forgiveness of Indebtedness	1
• Personal Expenses Paid by EO	16
• Loans to Individuals/Entities	2
• Unreasonable Housing Allowances	1
• Purchases/Sales Between EO and Officers, Directors, etc.	4

EXHIBIT C

MEDIA EVANGELIST EXAMINATIONS

June 30, 1993

Evangelist	Status	Private Benefit	Inurement: Compensation	Inurement: Other	Political Activities	Lobbying	UBIT	Emp. Tax	Income Tax
X	Closed		✓						✓
X1	Open	✓	✓	✓				✓	
X2	Closed								✓
X3	Open	✓	✓	✓				✓	✓
X4	Closed		✓						✓
X5	Open	✓	✓	✓	✓			✓	
X6	Closed		✓		✓	✓		✓	✓
X7	Closed								✓
X8	Open								✓
X9	Open	✓	✓	✓					
X10	Closed								✓
X11	Open		✓						
X12	Open		✓						✓
X13	Open							✓	
X14	Open		✓			✓			✓
X15	Open	✓		✓	✓				✓
X16	Open		✓			✓		✓	✓
X17	Open		✓					✓	✓
X18	Open							✓	✓
X19	Open		✓						✓
X20	Open		✓						✓

EXHIBIT D

HYPOTHETICAL CASES PRESENTING ISSUES
OF INUREMENT OR PRIVATE BENEFIT
AND THE IRS' APPROACH TO ANALYZING THESE ISSUES

These hypothetical cases have been prepared solely to illustrate the approach of the Internal Revenue Service to analyzing issues of inurement or private benefit. They are not based on actual cases and are not intended to be representative. The types of organizations involved in the hypothetical cases were chosen, in part, based upon specific requests from the Subcommittee staff. These cases should not be understood to suggest that the Service encounters more issues of inurement or private benefit in examinations of these types of organizations than it encounters in examinations of other types of organizations. Accompanying each case is an illustrative Form 990, Return of Organization Exempt From Income Tax, showing how the organization might report the transactions involved.

CASE A

Facts:

Minister A formed T.V. and Radio Show, Inc., (Show), a nonprofit charitable and religious organization, for the purpose of carrying his inspirational messages to a mass audience through weekly television programs. Show received recognition of exemption from the Internal Revenue Service as a charitable organization described in section 501(c)(3) and a public charity described in section 170(B)(1)(A)(vi).

The Board of Directors of Show consisted of A, his wife, and his elderly mother. A was chairman of the Board as well as the chief executive officer of Show. A hired his wife's brother-in-law, who had just graduated from college as a psychology major, to head Show's accounting staff. The accounting staff had previously been weeks behind in opening daily mail.

Show reported annual contributions from the public of \$40 million. Show's annual expenses were approximately \$43 million, including a \$500,000 salary and \$250,000 bonus paid to A, \$250,000 paid to A's wife for secretarial services, an additional \$100,000 paid to A's wife as a bonus, a \$100,000 director's fee paid to A's mother, and \$400,000 paid to a fashion designer to design A's personal and professional clothing.

Show's assets included a broadcast studio with a cost of \$2 million, a parsonage for A with a cost of \$2 million, and \$1 million receivable from A for an interest free loan. A's son, a contractor, built the broadcast studio under an agreement providing for cost plus 200%.

Issues Involving Potential Inurement:

A. Hiring of Wife's Brother-in-law

Show's hiring of A's wife's brother-in-law as the head of its accounting staff could result in private inurement if the compensation paid to the brother-in-law were unreasonable. The reasonableness of this compensation would be determined based on the amount paid by similar organizations to employees having similar responsibilities and qualifications. The brother-in-law's relationship to A and his lack of qualifications as an accounting supervisor, particularly in light of the problems

experienced by the accounting staff, suggest that inurement may be present. These factors, however, are not determinative.

B. Broadcast Studio Contract With Son

The fee paid to A's son appears to exceed that typically provided in similar contracts. Thus, the fee appears to represent indirect inurement to A. To avoid a finding of inurement, Show would have to demonstrate that the fee was reasonable.

C. Reasonableness of Compensation to A, A's Wife and Mother

Because A and his relatives control Show, the salaries that Show pays them are not determined at arm's length. This heightens the possibility that the compensation paid to A and his relatives is unreasonable and thus constitutes private inurement. The fact that compensation is not determined at arm's length, however, does not necessarily mean that the compensation is unreasonable. As noted above, the reasonableness of compensation is a fact-intensive inquiry, based on what similar organizations pay employees with similar responsibilities and qualifications.

D. Other Benefits Provided to A

The designer clothes, parsonage and interest-free loan provided to A would be considered part of A's total compensation package and would be taken into account in determining the reasonableness of A's compensation.

CASE (A)

Form 990 Department of the Treasury Internal Revenue Service	Return of Organization Exempt From Income Tax Under section 501(c) of the Internal Revenue Code (except black lung benefit trust or private foundation) or section 4947(a)(1) charitable trust	OMB No. 1545-0047 1992 This Form is Open to Public Inspection
Note: The organization may have to use a copy of this return to satisfy state reporting requirements.		
A For the calendar year 1992, or fiscal year beginning , 1992, and ending , 19		
Please use IRS label or print or type See Specific Instructions.	B Name of organization T.V. and Radio Show, Inc. Number and street (or P.O. box if mail is not delivered to street address) Room/suite 1111 Main Street City, town, or post office, state, and ZIP code Utopia, PA 11111	C Employer identification number 52-1234567 D State registration number 567890 E If address changed, check box <input type="checkbox"/>
F Check type of organization—Exempt under section <input checked="" type="checkbox"/> 501(c)(3) (insert number). OR <input type="checkbox"/> section 4947(a)(1) charitable trust		G If exemption application pending, check box <input type="checkbox"/>
H(a) Is this a group return filed for affiliates? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No (b) If "Yes," enter the number of affiliates for which this return is filed		I If either box in H is checked "Yes," enter four-digit group exemption number (GEN)
(c) Is this a separate return filed by an organization covered by a group ruling? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		J Accounting method <input type="checkbox"/> Cash <input checked="" type="checkbox"/> Accrual <input type="checkbox"/> Other (specify)
K Check here <input type="checkbox"/> if the organization's gross receipts are normally not more than \$25,000. The organization need not file a return with the IRS, but if it received a Form 990 Package in the mail, it should file a return without financial data. Some states require a complete return.		
Note: Form 990EZ may be used by organizations with gross receipts less than \$100,000 and total assets less than \$250,000 at end of year.		

Part I Statement of Revenue, Expenses, and Changes in Net Assets or Fund Balances

Revenue	1 Contributions, gifts, grants, and similar amounts received:			
	a Direct public support	1a	40,000,000	
	b Indirect public support	1b		
	c Government grants	1c		
	d Total (add lines 1a through 1c) (attach schedule—see instructions)	1d	40,000,000	
	2 Program service revenue (from Part VII, line 93)	2	2,000,000	
	3 Membership dues and assessments (see instructions)	3		
	4 Interest on savings and temporary cash investments	4		
	5 Dividends and interest from securities	5		
	6a Gross rents	6a		
	b Less: rental expenses	6b		
	c Net rental income or (loss)	6c		
7 Other investment income (describe)			7	
Expenses	8a Gross amount from sale of assets other than inventory	(A) Securities	(B) Other	
	b Less: cost or other basis and sales expenses	8a		
	c Gain or (loss) (attach schedule)	8b		
	d Net gain or (loss) (combine line 8c, columns (A) and (B))	8c		
	8d			
	9 Special fundraising events and activities (attach schedule—see instructions):			
	a Gross revenue (not including \$ of contributions reported on line 1a)	9a		
	b Less: direct expenses	9b		
	c Net income	9c		
	10a Gross sales less returns and allowances	10a		
Net Assets	b Less: cost of goods sold	10b		
	c Gross profit or (loss) (attach schedule)	10c		
	11 Other revenue (from Part VII, line 103)	11		
	12 Total revenue (add lines 1d, 2, 3, 4, 5, 6c, 7, 8d, 9c, 10c, and 11)	12	42,000,000	
	13 Program services (from line 44, column (B)) (see instructions)	13	42,000,000	
	14 Management and general (from line 44, column (C)) (see instructions)	14	500,000	
	15 Fundraising (from line 44, column (D)) (see instructions)	15	500,000	
	16 Payments to affiliates (attach schedule—see instructions)	16		
	17 Total expenses (add lines 16 and 44, column (A))	17	43,000,000	
	18 Excess or (deficit) for the year (subtract line 17 from line 12)	18	(1,000,000)	
19 Net assets or fund balances at beginning of year (from line 74, column (A))	19	4,000,000		
20 Other changes in net assets or fund balances (attach explanation)	20			
21 Net assets or fund balances at end of year (combine lines 18, 19, and 20)	21	3,000,000		

For Paperwork Reduction Act Notice, see page 1 of the separate instructions.

Cat No 11282Y

Form 990 (1992)

Part II Statement of Functional Expenses All organizations must complete column (A). Columns (B), (C), and (D) are required for section 501(c)(3) and (4) organizations and 4947(a)(1) charitable trusts but optional for others. (See instructions.)

Do not include amounts reported on line 6b, 8b, 9b, 10b, or 16 of Part I.		(A) Total	(B) Program services	(C) Management and general	(D) Fundraising
22	Grants and allocations (attach schedule) <input checked="" type="checkbox"/>	22 10,000,000	10,000,000		
23	Specific assistance to individuals (attach schedule)	23			
24	Benefits paid to or for members (attach schedule)	24			
25	Compensation of officers, directors, etc.	25 1,200,000	1,000,000	100,000	100,000
26	Other salaries and wages	26 200,000	200,000		
27	Pension plan contributions	27			
28	Other employee benefits	28			
29	Payroll taxes	29 100,000	100,000		
30	Professional fundraising fees	30			
31	Accounting fees	31			
32	Legal fees	32			
33	Supplies	33			
34	Telephone	34			
35	Postage and shipping	35			
36	Occupancy	36			
37	Equipment rental and maintenance	37			
38	Printing and publications	38			
39	Travel	39			
40	Conferences, conventions, and meetings	40			
41	Interest	41			
42	Depreciation, depletion, etc. (attach schedule)	42			
43	Other expenses (itemize): a Show expenses	43a 31,500,000	30,700,000	400,000	400,000
b		43b			
c	line 22 - FMV of used text	43c			
d	books to improve teaching of	43d			
e	science in under-developed	43e			
f	countries	43f			
44	Total functional expenses (add lines 22 through 43; Organizations completing columns (B)-(D), carry these totals to lines 13-15)	44 43,000,000	42,000,000	500,000	500,000

Reporting of Joint Costs.—Did you report in column (B) (Program services) any joint costs from a combined educational campaign and fundraising solicitation? Inspirational T.V. Program ☒ Yes ☐ No
 If "Yes," enter (i) the aggregate amount of these joint costs \$ 4,000,000; (ii) the amount allocated to program services \$ 3,500,000;
 (iii) the amount allocated to management and general \$ 250,000; and (iv) the amount allocated to fundraising \$ 250,000.

Part III Statement of Program Service Accomplishments (See instructions.)

Describe what was achieved in carrying out the organization's exempt purposes. Fully describe the services provided; the number of persons benefited; or other relevant information for each program title. Section 501(c)(3) and (4) organizations and section 4947(a)(1) charitable trusts must also enter the amount of grants and allocations to others.		Expenses (Required for 501(c)(3) and (4) organizations and 4947(a)(1) trusts; optional for others.)
a	Broadcast of Inspirational Messages ~ Daily T.V. program, reaching about 250,000 viewers per show (Grants and allocations \$)	31,000,000
(*) b	Educational Program to teach science to under-privileged children in under-developed countries (Grants and allocations \$)	10,000,000
c	Costs of Religious Articles (Grants and allocations \$)	1,000,000
d	 (Grants and allocations \$)	
e	Other program services (attach schedule) (Grants and allocations \$)	
f	Total (add lines a through e) (should equal line 44, column (B))	42,000,000

Part IV Balance Sheets

Note: Where required, attached schedules and amounts within the description column should be for end-of-year amounts only.		(A) Beginning of year	(B) End of year
Assets			
45	Cash—non-interest-bearing	3,000,000	45 — 0 —
46	Savings and temporary cash investments		46
47a	Accounts receivable		47a
b	Less: allowance for doubtful accounts		47b
48a	Pledges receivable		48a
b	Less: allowance for doubtful accounts		48b
49	Grants receivable		49
50	Receivables due from officers, directors, trustees, and key employees (attach schedule)	—	50 1,000,000
51a	Other notes and loans receivable (attach schedule)		51a
b	Less: allowance for doubtful accounts		51b
52	Inventories for sale or use <i>Undistributed text books</i>		52 150,000
53	Prepaid expenses and deferred charges		53
54	Investments—securities (attach schedule)		54
55a	Investments—land, buildings, and equipment: basis		55a
b	Less: accumulated depreciation (attach schedule)		55b
56	Investments—other (attach schedule)	<i>Set design</i>	56 400,000
57a	Land, buildings, and equipment: basis	<i>Personage</i>	57a 2,000,000
b	Less: accumulated depreciation (attach schedule)	<i>Broadcast Studio</i>	57b 2,000,000
58	Other assets (describe ►)		58
59	Total assets (add lines 45 through 58) (must equal line 75)	5,000,000	59 5,650,000
Liabilities			
60	Accounts payable and accrued expenses	800,000	60 2,650,000
61	Grants payable		61
62	Support and revenue designated for future periods (attach schedule)		62
63	Loans from officers, directors, trustees, and key employees (attach schedule)	200,000	63 —
64	Mortgages and other notes payable (attach schedule)		64
65	Other liabilities (describe ►)		65
66	Total liabilities (add lines 60 through 65)	1,000,000	66 2,650,000
Fund Balances or Net Assets			
Organizations that use fund accounting, check here ► <input type="checkbox"/> and complete lines 67 through 70 and lines 74 and 75 (see instructions).			
67a	Current unrestricted fund		67a
b	Current restricted fund		67b
68	Land, buildings, and equipment fund		68
69	Endowment fund		69
70	Other funds (describe ►)		70
Organizations that do not use fund accounting, check here ► <input checked="" type="checkbox"/> and complete lines 71 through 75 (see instructions).			
71	Capital stock or trust principal		71
72	Paid-in or capital surplus		72
73	Retained earnings or accumulated income	4,000,000	73 3,000,000
74	Total fund balances or net assets (add lines 67a through 70 OR lines 71 through 73: column (A) must equal line 19 and column (B) must equal line 21)	4,000,000	74 3,000,000
75	Total liabilities and fund balances/net assets (add lines 66 and 74)	5,000,000	75 5,650,000

Form 990 is available for public inspection and, for some people, serves as the primary or sole source of information about a particular organization. How the public perceives an organization in such cases may be determined by the information presented on its return. Therefore, please make sure the return is complete and accurate and fully describes the organization's programs and accomplishments.

Part V List of Officers, Directors, Trustees, and Key Employees (List each one even if not compensated. See instructions.)

(A) Name and address	(B) Title and average hours per week devoted to position	(C) Compensation (if not paid, enter -0-)	(D) Contributions to employee benefit plans	(E) Expense account and other allowances
Minister A Utopia, PA	Chairman of the Board & CEO -80hrs	500,000 250,000	Salary bonus	—
Minister A's wife Utopia, PA	Director -90hrs	250,000 100,000	Salary bonus	—
Minister A's elderly mother Utopia, PA	Director -40hrs	200,000	—	—

Did any officer, director, trustee, or key employee receive aggregate compensation of more than \$100,000 from your organization and all related organizations, of which more than \$10,000 was provided by the related organizations? ☐ Yes ☒ No
If "Yes," attach schedule (see instructions).

Part VI Other Information

Note: Section 501(c)(3) organizations and section 4947(a)(1) trusts must also complete and attach Schedule A (Form 990).

	Yes	No
76 Did the organization engage in any activity not previously reported to the Internal Revenue Service? If "Yes," attach a detailed description of each activity.	<input checked="" type="checkbox"/>	<input type="checkbox"/>
77 Were any changes made in the organizing or governing documents, but not reported to the IRS? If "Yes," attach a conformed copy of the changes.	<input checked="" type="checkbox"/>	<input type="checkbox"/>
78a Did the organization have unrelated business gross income of \$1,000 or more during the year covered by this return?	<input checked="" type="checkbox"/>	<input type="checkbox"/>
b If "Yes," has it filed a tax return on Form 990-T, Exempt Organization Business Income Tax Return, for this year?	<input checked="" type="checkbox"/>	<input type="checkbox"/>
c At any time during the year, did the organization own a 50% or greater interest in a taxable corporation or partnership? If "Yes," complete Part IX.	<input checked="" type="checkbox"/>	<input type="checkbox"/>
79 Was there a liquidation, dissolution, termination, or substantial contraction during the year? (See instructions.) If "Yes," attach a statement as described in the instructions.	<input checked="" type="checkbox"/>	<input type="checkbox"/>
80a Is the organization related (other than by association with a statewide or nationwide organization) through common membership, governing bodies, trustees, officers, etc., to any other exempt or non-exempt organization? (See instructions.)	<input checked="" type="checkbox"/>	<input type="checkbox"/>
b If "Yes," enter the name of the organization and check whether it is <input type="checkbox"/> exempt OR <input type="checkbox"/> nonexempt.		
81a Enter amount of political expenditures, direct or indirect, as described in the instructions. [81a] —	<input checked="" type="checkbox"/>	<input type="checkbox"/>
b Did the organization file Form 1120-POL, U.S. Income Tax Return for Certain Political Organizations, for this year?	<input checked="" type="checkbox"/>	<input type="checkbox"/>
82a Did the organization receive donated services or the use of materials, equipment, or facilities at no charge or at substantially less than fair rental value?	<input checked="" type="checkbox"/>	<input type="checkbox"/>
b If "Yes," you may indicate the value of these items here. Do not include this amount as revenue in Part I or as an expense in Part II. See instructions for reporting in Part III. [82b] N/A	<input checked="" type="checkbox"/>	<input type="checkbox"/>
83a Did anyone request to see either the organization's annual return or exemption application (or both)?	<input checked="" type="checkbox"/>	<input type="checkbox"/>
b If "Yes," did the organization comply as described in the instructions? (See General Instruction L.)	<input checked="" type="checkbox"/>	<input type="checkbox"/>
84a Did the organization solicit any contributions or gifts that were not tax deductible?	<input checked="" type="checkbox"/>	<input type="checkbox"/>
b If "Yes," did the organization include with every solicitation an express statement that such contributions or gifts were not tax deductible? (See General Instruction M.)	<input checked="" type="checkbox"/>	<input type="checkbox"/>
85a Section 501(c)(5) or (6) organizations.—Did the organization spend any amounts in attempts to influence public opinion about legislative matters or referendums? (See instructions and Regulations section 1.162-20(c).)	<input checked="" type="checkbox"/>	<input type="checkbox"/>
b If "Yes," enter the total amount spent for this purpose. [85b] N/A	<input checked="" type="checkbox"/>	<input type="checkbox"/>
86 Section 501(c)(7) organizations.—Enter:		
a Initiation fees and capital contributions included on line 12	<input checked="" type="checkbox"/>	<input type="checkbox"/>
b Gross receipts, included on line 12, for public use of club facilities (see instructions)	<input checked="" type="checkbox"/>	<input type="checkbox"/>
c Does the club's governing instrument or any written policy statement provide for discrimination against any person because of race, color, or religion? (If "Yes," attach statement. See instructions.)	<input checked="" type="checkbox"/>	<input type="checkbox"/>
87 Section 501(c)(12) organizations.—Enter amount of:		
a Gross income received from members or shareholders	<input checked="" type="checkbox"/>	<input type="checkbox"/>
b Gross income received from other sources. (Do not net amounts due or paid to other sources against amounts due or received from them.)	<input checked="" type="checkbox"/>	<input type="checkbox"/>
88 Public interest law firms.—Attach information described in the instructions.		
89 List the states with which a copy of this return is filed		
90 During this tax year did the organization maintain any part of its accounting / tax records on a computerized system?	<input checked="" type="checkbox"/>	<input type="checkbox"/>
91 The books are in care of Minister B's brother-in-law. Telephone no. (100) 123-456789 Located at 1111 Main Street, Utopia, PA ZIP code 11111		
92 Section 4947(a)(1) charitable trusts filing Form 990 in lieu of Form 1041, U.S. Fiduciary Income Tax Return, should check here <input type="checkbox"/> and enter the amount of tax-exempt interest received or accrued during the tax year. [92]		

Part VII Analysis of Income-Producing Activities

Enter gross amounts unless otherwise indicated.

	Unrelated business income		Excluded by section 512, 513, or 514		(e) Related or exempt function income (See instructions.)
	(a) Business code	(b) Amount	(c) Exclusion code	(d) Amount	
93 Program service revenue:					2,000,000
(a) <u>Sale of Religious Articles</u>					
(b) _____					
(c) _____					
(d) _____					
(e) _____					
(f) _____					
(g) Fees from government agencies					
94 Membership dues and assessments					
95 Interest on savings and temporary cash investments					
96 Dividends and interest from securities					
97 Net rental income or (loss) from real estate:					
(a) debt-financed property					
(b) not debt-financed property					
98 Net rental income or (loss) from personal property					
99 Other investment income					
100 Gain or (loss) from sales of assets other than inventory					
101 Net income from special fundraising events					
102 Gross profit or (loss) from sales of inventory					
103 Other revenue: (a) _____					
(b) _____					
(c) _____					
(d) _____					
(e) _____					
104 Subtotal (add columns (b), (d), and (e))					2,000,000
105 TOTAL (add line 104, columns (b), (d), and (e))					2,000,000

Note: (Line 105 plus line 1d, Part I, should equal the amount on line 12, Part I.)

Part VIII Relationship of Activities to the Accomplishment of Exempt Purposes

Line No. Explain how each activity for which income is reported in column (e) of Part VII contributed importantly to the accomplishment of the organization's exempt purposes (other than by providing funds for such purposes). (See instructions.)

93 Articles include literature and other items for inspirational purposes.

Part IX Information Regarding Taxable Subsidiaries (Complete this Part if the "Yes" box on 78c is checked.)

Name, address, and employer identification number of corporation or partnership	Percentage of ownership interest	Nature of business activities	Total income	End-of-year assets

Please
Sign
Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than officer) is based on all information of which preparer has any knowledge.

Signature of officer Minister A's Brother-in-lawDate 1-5-93Title BookkeeperPaid
Preparer's
Use OnlyPreparer's
signatureFirm's name (or
yours if self-employed)
and address

Date

ZIP code

Check if
self-employed ☐

Part IV Reason for Non-Private Foundation Status (See instructions for definitions.)

The organization is not a private foundation because it is (please check only ONE applicable box):

- 5 ☐ A church, convention of churches, or association of churches. Section 170(b)(1)(A)(i).
- 6 ☐ A school. Section 170(b)(1)(A)(ii). (Also complete Part V, page 3.)
- 7 ☐ A hospital or a cooperative hospital service organization. Section 170(b)(1)(A)(iii).
- 8 ☐ A Federal, state, or local government or governmental unit. Section 170(b)(1)(A)(iv).
- 9 ☐ A medical research organization operated in conjunction with a hospital. Section 170(b)(1)(A)(iii). Enter name, city, and state of hospital ►
- 10 ☐ An organization operated for the benefit of a college or university owned or operated by a governmental unit. Section 170(b)(1)(A)(iv). (Also complete Support Schedule.)
- 11a ☒ An organization that normally receives a substantial part of its support from a governmental unit or from the general public. Section 170(b)(1)(A)(vi). (Also complete Support Schedule.)
- 11b ☐ A community trust. Section 170(b)(1)(A)(vi). (Also complete Support Schedule.)
- 12 ☐ An organization that normally receives: (a) no more than 1/5 of its support from gross investment income and unrelated business taxable income (less section 511 tax) from businesses acquired by the organization after June 30, 1975, and (b) more than 1/5 of its support from contributions, membership fees, and gross receipts from activities related to its charitable, etc., functions—subject to certain exceptions. See section 509(a)(2). (Also complete Support Schedule.)
- 13 ☐ An organization that is not controlled by any disqualified persons (other than foundation managers) and supports organizations described in: (1) boxes 5 through 12 above; or (2) section 501(c)(4), (5), or (6), if they meet the test of section 509(a)(2). (See section 509(a)(3).)

Provide the following information about the supported organizations. (See instructions for Part IV, box 13.)

(a) Name(s) of supported organization(s)	(b) Box number from above

- 14 ☐ An organization organized and operated to test for public safety. Section 509(a)(4). (See specific instructions.)

Support Schedule (Complete only if you checked box 10, 11, or 12 above.) *Use cash method of accounting.*

Calendar year (or fiscal year beginning in) ►	(a) 1991	(b) 1990	(c) 1989	(d) 1988	(e) Total
15 Gifts, grants, and contributions received. (Do not include unusual grants. See line 28.)	9,000,000	8,000,000	7,000,000	6,000,000	30,000,000
16 Membership fees received	—	—	—	—	—
17 Gross receipts from admissions, merchandise sold or services performed, or furnishing of facilities in any activity that is not a business unrelated to the organization's charitable, etc., purpose	500,000	400,000	300,000	200,000	1,400,000
18 Gross income from interest, dividends, amounts received from payments on securities loans (section 512(a)(5)), rents, royalties, and unrelated business taxable income (less section 511 taxes) from businesses acquired by the organization after June 30, 1975	—	—	—	—	—
19 Net income from unrelated business activities not included in line 18	—	—	—	—	—
20 Tax revenues levied for the organization's benefit and either paid to it or expended on its behalf	—	—	—	—	—
21 The value of services or facilities furnished to the organization by a governmental unit without charge. Do not include the value of services or facilities generally furnished to the public without charge.	—	—	—	—	—
22 Other income. Attach schedule. Do not include gain or (loss) from sale of capital assets	—	—	—	—	—
23 Total of lines 15 through 22	9,500,000	8,400,000	7,300,000	6,200,000	31,400,000
24 Line 23 minus line 17	9,000,000	8,000,000	7,000,000	6,000,000	30,000,000
25 Enter 1% of line 23	—	—	—	—	—
26 Organizations described in box 10 or 11:					600,000
e Enter 2% of amount in column (a), line 24					—
b Attach a list (not open to public inspection) showing the name of and amount contributed by each person (other than a governmental unit or publicly supported organization) whose total gifts for 1988 through 1991 exceeded the amount shown in line 26a. Enter the sum of all excess amounts here ►					1,400,000

(Continued on page 3) ☒ Organization X

Part IV Support Schedule (continued) (Complete only if you checked box 10, 11, or 12 on page 2.)**27** Organizations described in box 12, page 2:

- a Attach a list for amounts shown on lines 15, 16, and 17, showing the name of, and total amounts received in each year from, each "disqualified person," and enter the sum of such amounts for each year:

(1991) (1990) (1989) (1988)

- b Attach a list showing, for 1988 through 1991, the name of, and amount included in line 17 for, each person (other than a "disqualified person") from whom the organization received more during that year than the larger of: (1) the amount on line 25 for the year; or (2) \$5,000. Include organizations described in boxes 5 through 11 as well as individuals. Enter the sum of these excess amounts for each year:

(1991) (1990) (1989) (1988)

28 For an organization described in box 10, 11, or 12, page 2, that received any unusual grants during 1988 through 1991, attach a list (not open to public inspection) for each year showing the name of the contributor, the date and amount of the grant, and a brief description of the nature of the grant. Do not include these grants in line 15. (See specific instructions.)**Part V** Private School Questionnaire

(To be completed ONLY by schools that checked box 6 in Part IV)

N/A

	Yes	No
29 Does the organization have a racially nondiscriminatory policy toward students by statement in its charter, bylaws, other governing instrument, or in a resolution of its governing body?		
30 Does the organization include a statement of its racially nondiscriminatory policy toward students in all its brochures, catalogues, and other written communications with the public dealing with student admissions, programs, and scholarships?		
31 Has the organization publicized its racially nondiscriminatory policy through newspaper or broadcast media during the period of solicitation for students, or during the registration period if it has no solicitation program, in a way that makes the policy known to all parts of the general community it serves? If "Yes," please describe; if "No," please explain. (If you need more space, attach a separate statement.)		
32 Does the organization maintain the following:		
a Records indicating the racial composition of the student body, faculty, and administrative staff?		
b Records documenting that scholarships and other financial assistance are awarded on a racially nondiscriminatory basis?		
c Copies of all catalogues, brochures, announcements, and other written communications to the public dealing with student admissions, programs, and scholarships?		
d Copies of all material used by the organization or on its behalf to solicit contributions? If you answered "No" to any of the above, please explain. (If you need more space, attach a separate statement.)		
33 Does the organization discriminate by race in any way with respect to:		
a Students' rights or privileges?		
b Admissions policies?		
c Employment of faculty or administrative staff?		
d Scholarships or other financial assistance? (See instructions.)		
e Educational policies?		
f Use of facilities?		
g Athletic programs?		
h Other extracurricular activities? If you answered "Yes" to any of the above, please explain. (If you need more space, attach a separate statement.)		
34a Does the organization receive any financial aid or assistance from a governmental agency?		
b Has the organization's right to such aid ever been revoked or suspended? If you answered "Yes" to either 34a or b, please explain using an attached statement.		
35 Does the organization certify that it has complied with the applicable requirements of sections 4.01 through 4.05 of Rev. Proc. 75-50, 1975-2 C.B. 587, covering racial nondiscrimination? If "No," attach an explanation. (See instructions for Part V.)		

Part VI-A Lobbying Expenditures by Electing Public Charities (see instructions)
(To be completed **ONLY** by an eligible organization that filed Form 5768)

N/A

Check here **a** ☐ If the organization belongs to an affiliated group (see instructions).Check here **b** ☐ If you checked **a** and "limited control" provisions apply (see instructions).**Limits on Lobbying Expenditures**

("Expenditures" means amounts paid or incurred)

		(a) Affiliated group totals	(b) To be completed for ALL electing organizations
36	Total lobbying expenditures to influence public opinion (grassroots lobbying)	36	
37	Total lobbying expenditures to influence a legislative body (direct lobbying)	37	
38	Total lobbying expenditures (add lines 36 and 37)	38	
39	Other exempt purpose expenditures (see Part VI-A instructions)	39	
40	Total exempt purpose expenditures (add lines 38 and 39) (see instructions)	40	
41	Lobbying nontaxable amount. Enter the amount from the following table— If the amount on line 40 is— The lobbying nontaxable amount is— Not over \$500,000 20% of the amount on line 40 Over \$500,000 but not over \$1,000,000 \$100,000 plus 15% of the excess over \$500,000 Over \$1,000,000 but not over \$1,500,000 \$175,000 plus 10% of the excess over \$1,000,000 Over \$1,500,000 but not over \$17,000,000 \$225,000 plus 5% of the excess over \$1,500,000 Over \$17,000,000 \$1,000,000	41	
42	Grassroots nontaxable amount (enter 25% of line 41)	42	
43	Subtract line 42 from line 36. Enter -0- if line 42 is more than line 36	43	
44	Subtract line 41 from line 38. Enter -0- if line 41 is more than line 38	44	

Caution: File Form 4720 if there is an amount on either line 43 or line 44.

4-Year Averaging Period Under Section 501(h)(Some organizations that made a section 501(h) election do not have to complete all of the five columns below.
See the instructions for lines 45–50 for details.)

Calendar year (or fiscal year beginning in) ▶	Lobbying Expenditures During 4-Year Averaging Period				
	(a) 1992	(b) 1991	(c) 1990	(d) 1989	(e) Total
45 Lobbying nontaxable amount (see instructions)					
46 Lobbying ceiling amount (150% of line 45(e))					
47 Total lobbying expenditures (see instructions)					
48 Grassroots nontaxable amount (see instructions)					
49 Grassroots ceiling amount (150% of line 48(e))					
50 Grassroots lobbying expenditures (see instructions)					

Part VI-B Lobbying Activity by Nonelecting Public Charities
(For reporting by organizations that did not complete Part VI-A.)

N/A

During the year, did the organization attempt to influence national, state or local legislation, including any attempt to influence public opinion on a legislative matter or referendum, through the use of:

	Yes	No	Amount
a Volunteers			
b Paid staff or management (include compensation in expenses reported on lines c through h)			
c Media advertisements			
d Mailings to members, legislators, or the public			
e Publications or published or broadcast statements			
f Grants to other organizations for lobbying purposes			
g Direct contact with legislators, their staffs, government officials, or a legislative body			
h Rallies, demonstrations, seminars, conventions, speeches, lectures, or any other means			
i Total lobbying expenditures (add lines c through h)			

If "Yes" to any of the above, also attach a statement giving a detailed description of the lobbying activities.

Part VII Information Regarding Transfers To and Transactions and Relationships With Noncharitable Exempt Organizations

- 51 Did the reporting organization directly or indirectly engage in any of the following with any other organization described in section 501(c) of the Code (other than section 501(c)(3) organizations) or in section 527, relating to political organizations?

		Yes	No
a	Transfers from the reporting organization to a noncharitable exempt organization of:	51a(i)	X
	(i) Cash	a(ii)	X
	(ii) Other assets		X
b	Other Transactions:		
	(i) Sales of assets to a noncharitable exempt organization	b(i)	X
	(ii) Purchases of assets from a noncharitable exempt organization	b(ii)	X
	(iii) Rental of facilities or equipment	b(iii)	X
	(iv) Reimbursement arrangements	b(iv)	X
	(v) Loans or loan guarantees	b(v)	X
	(vi) Performance of services or membership or fundraising solicitations	b(vi)	X
c	Sharing of facilities, equipment, mailing lists or other assets, or paid employees	c	X

- d If the answer to any of the above is "Yes," complete the following schedule. The "Amount involved" column below should always indicate the fair market value of the goods, other assets, or services given by the reporting organization. If the organization received less than fair market value in any transaction or sharing arrangement, indicate in column (d) the value of the goods, other assets, or services received.

[illegible]

- 52a Is the organization directly or indirectly affiliated with, or related to, one or more tax-exempt organizations described in section 501(c) of the Code (other than section 501(c)(3)) or in section 527? ☐ Yes ☐ No
- b If "Yes," complete the following schedule.

[illegible]

CASE BFacts:

Professor B is the president of "College." B earns a salary of \$150,000. B hired "Coach" to recruit players and build a successful athletic program. Coach receives a salary of \$400,000 from College. College's Alumni Association pays Coach \$100,000 annually. Coach also receives \$500,000 pursuant to a contract with a shoe company. The total amount that Coach receives annually is comparable to what he earned as a coach in a professional league.

B asked College's board of directors to refurbish the on-campus residence of the president at a cost of \$5 million, and to provide him with a private airplane and pilot, chauffeured limousine service, and an annual entertainment budget of \$100,000. B also requested that his salary be re-determined so that it would be 20% higher than that paid to any other university employee. The board approved all these requests.

B directed the head of College's English Department to add a novel B had written to the reading list of the literature course that College requires all freshmen to complete. B privately published the book and sold it to the university for \$100 per copy.

Issues Involving Potential Inurement:

A. B's Salary

The reasonableness of B's salary is determined based on what similar colleges pay to their presidents. Without knowing more facts, such as the size of College's student body and faculty, the specific responsibilities of B's position, and the size of College's endowment, it is impossible to tell whether B's salary is reasonable. In making this determination, the increase in B's salary from \$150,000 to \$480,000 would, of course, be considered, as well as any indirect benefits B receives from College, such as those addressed in Part (C) below.

B. Coach's Salary

The reasonableness of Coach's compensation would be determined based on what similar colleges pay the directors of their athletic programs. Depending on the relationship between College and its Alumni Association, the \$100,000 paid to Coach by the Association might be taken into account as part of his total compensation package for his services to College. Because the amount Coach receives from the shoe company comes from a source other than College, that amount would not be taken into account as part of his compensation from College.

If we were to determine that Coach's compensation is unreasonable, we would then have to determine whether Coach is an insider. If Coach is not an insider, any unreasonable compensation would not be inurement. Nonetheless, the unreasonable compensation would be a private benefit that, unless incidental, would jeopardize College's tax-exempt status.

C. Other Benefits Provided to B.

Any benefits provided by College to B that do not directly further College's exempt purpose would be taken into account in determining the reasonableness of B's total compensation. In analyzing this issue, we would consider the refurbishing of the on-campus residence, the private airplane, the chauffeured limousine, the substantial annual entertainment budget, and the purchase by College of B's novel.

1992

This Form is
Open to Public
Inspection

990

Return of Organization Exempt From Income Tax

Under section 501(c) of the Internal Revenue Code (except black lung benefit trust or private foundation) or section 4947(a)(1) charitable trust

Department of the Treasury
Internal Revenue Service

Note: The organization may have to use a copy of this return to satisfy state reporting requirements.

A For the calendar year 1992, or fiscal year beginning JULY 1, 1992, and ending JUNE 30, 1993

Please use IRS label or print or type. See Specific Instructions.	B Name of organization TRUSTEES OF THE COLLEGE		C Employer identification number 22-3456789	
	Number and street (or P.O. box if mail is not delivered to street address) 2222 MAIN ST.		D State registration number 678901	
	City, town, or post office, state, and ZIP code UTOPIA PA 11111		E If address changed, check box <input type="checkbox"/>	

F Check type of organization—Exempt under section ☒ 501(c)(3) (insert number), OR ☐ section 4947(a)(1) charitable trustG If exemption application pending, check box ☐H(a) Is this a group return filed for affiliates? ☐ Yes ☒ NoI If either box in H is checked "Yes," enter four-digit group exemption number (GEN) ☐(b) If "Yes," enter the number of affiliates for which this return is filed: ☐J Accounting method: ☐ Cash ☒ Accrual
☐ Other (specify) ☐(c) Is this a separate return filed by an organization covered by a group ruling? ☐ Yes ☒ NoK Check here ☐ if the organization's gross receipts are normally not more than \$25,000. The organization need not file a return with the IRS, but if it received a Form 990 Package in the mail, it should file a return without financial data. Some states require a complete return.

Note: Form 990EZ may be used by organizations with gross receipts less than \$100,000 and total assets less than \$250,000 at end of year.

Part I Statement of Revenue, Expenses, and Changes in Net Assets or Fund Balances

Revenue	1	Contributions, gifts, grants, and similar amounts received:				
	a	Direct public support	1a	80,000,000		
	b	Indirect public support	1b			
	c	Government grants	1c	2,000,000		
	d	Total (add lines 1a through 1c) (attach schedule—see instructions)	1d	82,000,000		
	2	Program service revenue (from Part VII, line 93)	2	100,000,000		
	3	Membership dues and assessments (see instructions)	3			
	4	Interest on savings and temporary cash investments	4	1,000,000		
	5	Dividends and interest from securities	5	2,000,000		
	6a	Gross rents	6a			
	6b	Less: rental expenses	6b			
	6c	Net rental income or (loss)	6c			
7	Other investment income (describe <input type="checkbox"/>)	7				
Expenses	8a	Gross amount from sale of assets other than inventory	(A) Securities	4,000,000	8a	
	b	Less: cost or other basis and sales expenses	2,000,000	6b		
	c	Gain or (loss) (attach schedule)	2,000,000	8c		
	d	Net gain or (loss) (combine line 8c, columns (A) and (B))		8d	2,000,000	
	9	Special fundraising events and activities (attach schedule—see instructions):				
	e	Gross revenue (not including \$_____ of contributions reported on line 1a)	9a			
	b	Less: direct expenses	9b			
	c	Net income	9c			
	10a	Gross sales less returns and allowances	10a	26,000,000		
	b	Less: cost of goods sold	10b	8,000,000		
	c	Gross profit or (loss) (attach schedule)			10c	18,000,000
	11	Other revenue (from Part VII, line 103)	11			
12	Total revenue (add lines 1d, 2, 3, 4, 5, 6c, 7, 8d, 9c, 10c, and 11)	12	205,000,000			
Net Assets	13	Program services (from line 44, column (B)) (see instructions)	13	161,250,000		
	14	Management and general (from line 44, column (C)) (see instructions)	14	16,650,000		
	15	Fundraising (from line 44, column (D)) (see instructions)	15	3,100,000		
	16	Payments to affiliates (attach schedule—see instructions)	16			
	17	Total expenses (add lines 16 and 44, column (A))	17	181,000,000		
Net Assets	18	Excess or (deficit) for the year (subtract line 17 from line 12)	18	24,000,000		
	19	Net assets or fund balances at beginning of year (from line 74, column (A))	19	115,100,000		
	20	Other changes in net assets or fund balances (attach explanation)	20			
	21	Net assets or fund balances at end of year (combine lines 18, 19, and 20)	21	139,100,000		

For Paperwork Reduction Act Notice, see page 1 of the separate instructions.

Cat No 11282Y

Form 990 (1992)

Part II Statement of Functional Expenses

All organizations must complete column (A). Columns (B), (C), and (D) are required for section 501(c)(3) and (4) organizations and 4947(a)(1) charitable trusts but optional for others. (See instructions.)

Do not include amounts reported on line 6b, 8b, 9b, 10b, or 16 of Part I.

	(A) Total	(B) Program services	(C) Management and general	(D) Fundraising
22 Grants and allocations (attach schedule)	22 1,000,000	1,000,000		
23 Specific assistance to individuals (attach schedule)	23			
24 Benefits paid to or for members (attach schedule)	24			
25 Compensation of officers, directors, etc.	25 1,200,000	100,000	900,000	200,000
26 Other salaries and wages	26 90,000,000	85,000,000	4,000,000	1,000,000
27 Pension plan contributions	27 6,000,000	5,000,000	800,000	200,000
28 Other employee benefits	28 8,000,000	7,000,000	800,000	200,000
29 Payroll taxes	29 6,000,000	5,000,000	800,000	200,000
30 Professional fundraising fees	30 100,000			100,000
31 Accounting fees	31 500,000		500,000	
32 Legal fees	32 750,000	600,000	150,000	
33 Supplies	33 20,000,000	19,000,000	900,000	100,000
34 Telephone	34 2,000,000	1,000,000	600,000	400,000
35 Postage and shipping	35 650,000	450,000	100,000	100,000
36 Occupancy	36 6,000,000	5,000,000	900,000	100,000
37 Equipment rental and maintenance	37 8,000,000	7,500,000	500,000	
38 Printing and publications	38			
39 Travel	39 5,000,000	4,000,000	1,000,000	
40 Conferences, conventions, and meetings	40 800,000	600,000	200,000	
41 Interest	41			
42 Depreciation, depletion, etc. (attach schedule)	42			
43 Other expenses (itemize): a INSURANCE	43a 2,000,000	1,000,000	1,000,000	
b EQUIPMENT	43b 9,000,000	8,000,000	900,000	100,000
c INVESTMENT ADVISORY	43c 1,000,000		1,000,000	
d OTHER OUTSIDE SERVICES	43d 10,000,000	9,000,000	800,000	200,000
e MISCELLANEOUS	43e 3,000,000	2,000,000	800,000	200,000
f	43f			
44 Total functional expenses (add lines 22 through 43). Organizations completing columns (B)-(D), carry these totals to lines 13-15.	44 181,000,000	161,250,000	16,650,000	3,100,000

Reporting of Joint Costs.—Did you report in column (B) (Program services) any joint costs from a combined educational campaign and fundraising solicitation? ☐ Yes ☒ No

If "Yes," enter (i) the aggregate amount of these joint costs \$ _____; (ii) the amount allocated to program services \$ _____;

(iii) the amount allocated to management and general \$ _____; and (iv) the amount allocated to fundraising \$ _____.

Part III Statement of Program Service Accomplishments (See instructions.)

Describe what was achieved in carrying out the organization's exempt purposes. Fully describe the services provided; the number of persons benefited, or other relevant information for each program title. Section 501(c)(3) and (4) organizations and section 4947(a)(1) charitable trusts must also enter the amount of grants and allocations to others.

Expenses
(Required for 501(c)(3) and (4) organizations and 4947(a)(1) trusts, optional for others.)

a INSTRUCTION! 10,000 STUDENTS IN UNDERGRADUATE CLASSES 1,000 STUDENTS IN GRADUATE CLASSES 2,000 GRADUATES IN 1992-93 ACADEMIC YEAR (Grants and allocations \$ 1,000,000)	147,250,000
b AUXILIARY ENTERPRISE EXPENSES (Grants and allocations \$)	14,000,000
c (Grants and allocations \$)	
d (Grants and allocations \$)	
e Other program services (attach schedule) (Grants and allocations \$)	
f Total (add lines a through e) (should equal line 44, column (B))	161,250,000

Part IV Balance Sheets

Note: Where required, attached schedules and amounts within the description column should be for end of year amounts only		(A) Beginning of year	(B) End of year
Assets			
45	Cash—non-interest-bearing	100,000	45 200,000
46	Savings and temporary cash investments	15,000,000	46 20,000,000
47a	Accounts receivable	47a 3,200,000	
b	Less: allowance for doubtful accounts	47b 200,000	47c 3,000,000
48a	Pledges receivable	48a	
b	Less: allowance for doubtful accounts	48b	48c
49	Grants receivable	500,000	49 1,500,000
50	Receivables due from officers, directors, trustees, and key employees (attach schedule)		50
51a	Other notes and loans receivable (attach schedule)	51a 4,000,000	
b	Less: allowance for doubtful accounts	51b 500,000	51c 3,500,000
52	Inventories for sale or use	2,000,000	52 3,000,000
53	Prepaid expenses and deferred charges	500,000	53 1,000,000
54	Investments—securities (attach schedule)	28,000,000	54 30,000,000
55a	Investments—land, buildings, and equipment: basis	55a	
b	Less: accumulated depreciation (attach schedule)	55b	55c
56	Investments—other (attach schedule)		56
57a	Land, buildings, and equipment: basis	57a 130,000,000	
b	Less: accumulated depreciation (attach schedule)	57b - 0 -	57c 130,000,000
58	Other assets (describe ▶)		58
59	Total assets (add lines 45 through 58) (must equal line 75)	170,100,000	59 192,200,000
Liabilities			
60	Accounts payable and accrued expenses	12,000,000	60 10,000,000
61	Grants payable		61
62	Support and revenue designated for future periods (attach schedule)		62
63	Loans from officers, directors, trustees, and key employees (attach schedule)		63
64	Mortgages and other notes payable (attach schedule)	40,000,000	64 39,000,000
65	Other liabilities (describe ▶ STUDENT + OTHER DEPOSITS)	3,000,000	65 4,100,000
66	Total liabilities (add lines 60 through 65)	55,000,000	66 53,100,000
Fund Balances or Net Assets			
Organizations that use fund accounting, check here <input checked="" type="checkbox"/> and complete lines 67 through 70 and lines 74 and 75 (see instructions).			
67a	Current unrestricted fund	8,100,000	67a 11,100,000
b	Current restricted fund	2,000,000	67b 3,000,000
68	Land, buildings, and equipment fund	85,000,000	68 95,000,000
69	Endowment fund	20,000,000	69 30,000,000
70	Other funds (describe ▶)		70
Organizations that do not use fund accounting, check here <input type="checkbox"/> and complete lines 71 through 75 (see instructions)			
71	Capital stock or trust principal		71
72	Paid-in or capital surplus		72
73	Retained earnings or accumulated income		73
74	Total fund balances or net assets (add lines 67a through 70 OR lines 71 through 73: column (A) must equal line 19 and column (B) must equal line 21)	115,100,000	74 139,100,000
75	Total liabilities and fund balances/net assets (add lines 66 and 74)	170,100,000	75 192,200,000

Form 990 is available for public inspection and, for some people, serves as the primary or sole source of information about a particular organization. How the public perceives an organization in such cases may be determined by the information presented on its return. Therefore, please make sure the return is complete and accurate and fully describes the organization's programs and accomplishments.

Part V List of Officers, Directors, Trustees, and Key Employees (List each one even if not compensated. See instructions.)

(A) Name and address	(B) Title and average hours per week devoted to position	(C) Compensation (if not paid, enter -0-)	(D) Contributions to employee benefit plans	(E) Expense account and other allowances
PROFESSOR B UTOPIA, PA	PRESIDENT 80 HRS	1,200,000	240,000	200,000
TRUSTEE A UTOPIA, PA	TRUSTEE 30 HRS	-	-	-
TRUSTEE B UTOPIA, PA	TRUSTEE 20 HRS	-	-	-
TRUSTEE C UTOPIA, PA	TRUSTEE 20 HRS	-	-	-

Did any officer, director, trustee, or key employee receive aggregate compensation of more than \$100,000 from your organization and all related organizations, of which more than \$10,000 was provided by the related organizations? ☐ Yes ☒ No
If "Yes," attach schedule (see instructions).

Part VI Other Information

Note: Section 501(c)(3) organizations and section 4947(a)(1) trusts must also complete and attach Schedule A (Form 990).

	Yes	No
76 Did the organization engage in any activity not previously reported to the Internal Revenue Service? If "Yes," attach a detailed description of each activity.	76	X
77 Were any changes made in the organizing or governing documents, but not reported to the IRS? If "Yes," attach a conformed copy of the changes.	77	X
78a Did the organization have unrelated business gross income of \$1,000 or more during the year covered by this return?	78a	X
b If "Yes," has it filed a tax return on Form 990-T, Exempt Organization Business Income Tax Return, for this year?	78b	X
c At any time during the year, did the organization own a 50% or greater interest in a taxable corporation or partnership? If "Yes," complete Part IX.	78c	X
79 Was there a liquidation, dissolution, termination, or substantial contraction during the year? (See instructions.) If "Yes," attach a statement as described in the instructions.	79	X
80a Is the organization related (other than by association with a statewide or nationwide organization) through common membership, governing bodies, trustees, officers, etc., to any other exempt or non-exempt organization? (See instructions.) b If "Yes," enter the name of the organization and check whether it is <input type="checkbox"/> exempt OR <input type="checkbox"/> nonexempt.	80a	X
81a Enter amount of political expenditures, direct or indirect, as described in the instructions.	81a	-0-
b Did the organization file Form 1120-POL, U.S. Income Tax Return for Certain Political Organizations, for this year?	81b	X
82a Did the organization receive donated services or the use of materials, equipment, or facilities at no charge or at substantially less than fair rental value? b If "Yes," you may indicate the value of these items here. Do not include this amount as revenue in Part I or as an expense in Part II. See instructions for reporting in Part III.	82a	X
83a Did anyone request to see either the organization's annual return or exemption application (or both)? b If "Yes," did the organization comply as described in the instructions? (See General Instruction L.)	83a	X
84a Did the organization solicit any contributions or gifts that were not tax deductible? b If "Yes," did the organization include with every solicitation an express statement that such contributions or gifts were not tax deductible? (See General Instruction M.)	84a	X
85a Section 501(c)(5) or (6) organizations.—Did the organization spend any amounts in attempts to influence public opinion about legislative matters or referendums? (See instructions and Regulations section 1.162-20(c).) b If "Yes," enter the total amount spent for this purpose.	85a	N/A
86 Section 501(c)(7) organizations.—Enter: a Initiation fees and capital contributions included on line 12 b Gross receipts, included on line 12, for public use of club facilities (see instructions) c Does the club's governing instrument or any written policy statement provide for discrimination against any person because of race, color, or religion? (If "Yes," attach statement. See instructions.)	86a	N/A
87 Section 501(c)(12) organizations.—Enter amount of: a Gross income received from members or shareholders b Gross income received from other sources. (Do not net amounts due or paid to other sources against amounts due or received from them.)	87a	N/A
88 Public interest law firms.—Attach information described in the instructions	87b	N/A
89 List the states with which a copy of this return is filed	90	X
90 During this tax year did the organization maintain any part of its accounting / tax records on a computerized system?		
91 The books are in care of <u>BUSINESS OFFICE A</u> Telephone no. <u>(222) 123-4567</u> Located at <u>222 MAIN ST., UTOPIA, PA</u> ZIP code <u>11111</u>		
92 Section 4947(a)(1) charitable trusts filing Form 990 in lieu of Form 1041, U.S. Fiduciary Income Tax Return, should check here <input type="checkbox"/> and enter the amount of tax exempt interest received or accrued during the tax year.	92	

Form 990 (1997)

Page 5

Part VII Analysis of Income-Producing Activities

Enter gross amounts unless otherwise indicated.

	Unrelated business income		Excluded by section 512, 513, or 514		(e) Related or exempt function income (See instructions.)
	(a) Business code	(b) Amount	(c) Exclusion code	(d) Amount	
93 Program service revenue:					
(a) TUITION AND FEES					80,000.00
(b) AUXILIARY ENTERPRISE REVENUE					28,000.00
(c)					
(d)					
(e)					
(f)					
(g) Fees from government agencies					
94 Membership dues and assessments					
95 Interest on savings and temporary cash investments			14	1,000.00	
96 Dividends and interest from securities			14	2,000.00	
97 Net rental income or (loss) from real estate:					
(a) debt-financed property					
(b) not debt-financed property					
98 Net rental income or (loss) from personal property					
99 Other investment income					
100 Gain or (loss) from sales of assets other than inventory			18	2,000.00	
101 Net income from special fundraising events					
102 Gross profit or (loss) from sales of inventory					18,000.00
103 Other revenue: (a)					
(b)					
(c)					
(d)					
(e)					
104 Subtotal (add columns (b), (d), and (e))				5,000.00	118,000.00
105 TOTAL (add line 104, columns (b), (d), and (e))					123,000.00

Note: (Line 105 plus line 1d, Part I, should equal the amount on line 12, Part I.)

Part VIII Relationship of Activities to the Accomplishment of Exempt Purposes

Line No.	Explain how each activity for which income is reported in column (e) of Part VII contributed importantly to the accomplishment of the organization's exempt purposes (other than by providing funds for such purposes). (See instructions.)
93(a)	INSTRUCTION AND EDUCATION OF COLLEGE STUDENTS
93(b)	REVENUE FROM ATHLETIC DEPARTMENT, DORMITORIES, DINING HALLS, STUDENT UNION, PERFORMING ARTS EVENTS, AND OTHER RECEIPTS FROM STUDENTS, FACULTY, AND THE PUBLIC
102	SALE OF EDUCATIONAL MATERIALS TO STUDENTS AND THE PUBLIC

Part IX Information Regarding Taxable Subsidiaries (Complete this Part if the "Yes" box on 78c is checked.)

Name, address, and employer identification number of corporation or partnership	Percentage of ownership interest	Nature of business activities	Total income	End-of-year assets
N/A				

Please Sign Here	Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than officer) is based on all information of which preparer has any knowledge.		
	Signature of officer Professor B	Date 1/9/30/93	Title President
Paid Preparer's Use Only	Preparer's signature	Date	Check if self-employed <input type="checkbox"/>
	Firm's name (or yours if self-employed) and address	ZIP code	

SCHEDULE A
(Form 990)
Organization Exempt Under Section 501(c)(3)
 (Except Private Foundations, 501(c), 501(j), 501(k), or Section 4947(a)(1) Charitable Trust
 Supplementary Information

OMB No. 1545-0047

Department of the Treasury
Internal Revenue Service

▶ Attach to Form 990 (or Form 990EZ).

1092

 Name **TRUSTEES OF THE COLLEGE** Employer identification number **22-3456789**
Part I Compensation of the Five Highest Paid Employees Other Than Officers, Directors, and Trustees
 (See specific instructions.) (List each one. If there are none, enter "None.")

(a) Name and address of employee paid more than \$30,000	(b) Title and average hours per week devoted to position	(c) Compensation	(d) Contributions to employee benefit plans	(e) Expense account and other allowances
COACH M UTOPIA, PA	ATHLETIC COACH 60 HRS	400,000	200,000	120,000
PROFESSOR M UTOPIA, PA	PROFESSOR 40 HRS	90,000	12,000	-
PROFESSOR N UTOPIA, PA	PROFESSOR 40 HRS	85,000	10,000	-
PROFESSOR O UTOPIA, PA	PROFESSOR 40 HRS	80,000	8,000	-
PROFESSOR P UTOPIA, PA	PROFESSOR 40 HRS	75,000	7,000	-
Total number of other employees paid over \$30,000 ▶	200			

Part II Compensation of the Five Highest Paid Persons for Professional Services
 (See specific instructions.) (List each one. If there are none, enter "None.")

(a) Name and address of persons paid more than \$30,000	(b) Type of service	(c) Compensation
AA INVESTMENT ADVISOR UTOPIA, PA	PORTFOLIO MANAGEMENT	1,000,000
AA LAW FIRM UTOPIA, PA	LEGAL	750,000
AA ACCOUNTANTS UTOPIA, PA	AUDITING	500,000
AA DESIGNERS UTOPIA, PA	ARCHITECTURAL	250,000
AA CONSULTANTS UTOPIA, PA	FUNDRAISING	100,000
Total number of others receiving over \$30,000 for professional services ▶	3	

Part III Statements About Activities

	Yes	No
1 During the year, has the organization attempted to influence national, state, or local legislation, including any attempt to influence public opinion on a legislative matter or referendum? If "Yes," enter the total expenses paid or incurred in connection with the lobbying activities. \$ _____ Organizations that made an election under section 501(h) by filing Form 5768 must complete Part VI-A. Other organizations checking "Yes," must complete Part VI-B AND attach a statement giving a detailed description of the lobbying activities.		X
2 During the year, has the organization, either directly or indirectly, engaged in any of the following acts with any of its trustees, directors, principal officers, or creators, or with any taxable organization or corporation with which any such person is affiliated as an officer, director, trustee, majority owner, or principal beneficiary: a Sale, exchange, or leasing of property? PURCHASE OF EDUCATIONAL TEXTS FROM PROFESSOR B	X	
b Lending of money or other extension of credit?	X	
c Furnishing of goods, services, or facilities? RESIDENCE AND TRANSPORTATION FOR PROFESSOR B	X	
d Payment of compensation (or payment or reimbursement of expenses if more than \$1,000)?	X	
e Transfer of any part of its income or assets?		X
If the answer to any question is "Yes," attach a detailed statement explaining the transactions.		
3 Does the organization make grants for scholarships, fellowships, student loans, etc.?	X	
4 Attach a statement explaining how the organization determines that individuals or organizations receiving grants or loans from it in furtherance of its charitable programs qualify to receive payments. (See specific instructions.)		

Part IV Reason for Non-Private Foundation Status (See instructions for definitions.)The organization is not a private foundation because it is (please check only **ONE** applicable box)

- 5 ☐ A church, convention of churches, or association of churches. Section 170(b)(1)(A)(i)
- 6 ☒ A school. Section 170(b)(1)(A)(ii). (Also complete Part V, page 3.)
- 7 ☐ A hospital or a cooperative hospital service organization. Section 170(b)(1)(A)(iii).
- 8 ☐ A Federal, state, or local government or governmental unit. Section 170(b)(1)(A)(v).
- 9 ☐ A medical research organization operated in conjunction with a hospital. Section 170(b)(1)(A)(iii). Enter name, city, and state of hospital ►
- 10 ☐ An organization operated for the benefit of a college or university owned or operated by a governmental unit. Section 170(b)(1)(A)(iv). (Also complete Support Schedule.)
- 11a ☐ An organization that normally receives a substantial part of its support from a governmental unit or from the general public. Section 170(b)(1)(A)(vi). (Also complete Support Schedule.)
- 11b ☐ A community trust. Section 170(b)(1)(A)(vi). (Also complete Support Schedule.)
- 12 ☐ An organization that normally receives: (a) no more than 1/5 of its support from gross investment income and unrelated business taxable income (less section 511 tax) from businesses acquired by the organization after June 30, 1975, and (b) more than 1/5 of its support from contributions, membership fees, and gross receipts from activities related to its charitable, etc., functions—subject to certain exceptions. See section 509(a)(2). (Also complete Support Schedule.)
- 13 ☐ An organization that is not controlled by any disqualified persons (other than foundation managers) and supports organizations described in: (1) boxes 5 through 12 above; or (2) section 501(c)(4), (5), or (6). If they meet the test of section 509(a)(2). (See section 509(a)(3).)

Provide the following information about the supported organizations. (See instructions for Part IV, box 13.)

(a) Name(s) of supported organization(s)	(b) Box number from above

- 14 ☐ An organization organized and operated to test for public safety. Section 509(e)(4). (See specific instructions.)

Support Schedule (Complete only if you checked box 10, 11, or 12 above.) *Use cash method of accounting.*

Calendar year (or fiscal year beginning in) ►	(a) 1991	(b) 1990	(c) 1989	(d) 1988	(e) Total
15 Gifts, grants, and contributions received. (Do not include unusual grants. See line 28.)					
16 Membership fees received					
17 Gross receipts from admissions, merchandise sold or services performed, or furnishing of facilities in any activity that is not a business unrelated to the organization's charitable, etc., purpose					
18 Gross income from interest, dividends, amounts received from payments on securities loans (section 512(a)(5)), rents, royalties, and unrelated business taxable income (less section 511 taxes) from businesses acquired by the organization after June 30, 1975.					
19 Net income from unrelated business activities not included in line 18					
20 Tax revenues levied for the organization's benefit and either paid to it or expended on its behalf					
21 The value of services or facilities furnished to the organization by a governmental unit without charge. Do not include the value of services or facilities generally furnished to the public without charge.					
22 Other income. Attach schedule. Do not include gain or (loss) from sale of capital assets.					
23 Total of lines 15 through 22.					
24 Line 23 minus line 17.					
25 Enter 1% of line 23					
26 Organizations described in box 10 or 11:					
a Enter 2% of amount in column (e), line 24					
b Attach a list (not open to public inspection) showing the name of and amount contributed by each person (other than a governmental unit or publicly supported organization) whose total gifts for 1988 through 1991 exceeded the amount shown in line 26a. Enter the sum of all excess amounts here ►					

(Continued on page 3)

Part IV Support Schedule (continued) (Complete only if you checked box 10, 11, or 12 on page 2.)**27 Organizations described in box 12, page 2**

- a Attach a list for amounts shown on lines 15, 16, and 17, showing the name of, and total amounts received in each year from, each "disqualified person," and enter the sum of such amounts for each year:

(1991) (1990) (1989) (1988)

- b Attach a list showing, for 1988 through 1991, the name of, and amount included in line 17 for, each person (other than a "disqualified person") from whom the organization received more during that year than the larger of: (1) the amount on line 25 for the year; or (2) \$5,000. Include organizations described in boxes 5 through 11 as well as individuals. Enter the sum of these excess amounts for each year:

(1991) (1990) (1989) (1988)

- 28 For an organization described in box 10, 11, or 12, page 2, that received any unusual grants during 1988 through 1991, attach a list (not open to public inspection) for each year showing the name of the contributor, the date and amount of the grant, and a brief description of the nature of the grant. Do not include these grants in line 15. (See specific instructions.)

Part V Private School Questionnaire
(To be completed ONLY by schools that checked box 6 in Part IV)

	Yes	No
29 Does the organization have a racially nondiscriminatory policy toward students by statement in its charter, bylaws, other governing instrument, or in a resolution of its governing body?	29 X	
30 Does the organization include a statement of its racially nondiscriminatory policy toward students in all its brochures, catalogues, and other written communications with the public dealing with student admissions, programs, and scholarships?	30 X	
31 Has the organization publicized its racially nondiscriminatory policy through newspaper or broadcast media during the period of solicitation for students, or during the registration period if it has no solicitation program, in a way that makes the policy known to all parts of the general community it serves? If "Yes," please describe; if "No," please explain. (If you need more space, attach a separate statement.)	31 X	
32 Does the organization maintain the following:		
a Records indicating the racial composition of the student body, faculty, and administrative staff?	32a X	
b Records documenting that scholarships and other financial assistance are awarded on a racially nondiscriminatory basis?	32b X	
c Copies of all catalogues, brochures, announcements, and other written communications to the public dealing with student admissions, programs, and scholarships?	32c X	
d Copies of all material used by the organization or on its behalf to solicit contributions? If you answered "No" to any of the above, please explain. (If you need more space, attach a separate statement.)	32d X	
33 Does the organization discriminate by race in any way with respect to:		
a Students' rights or privileges?	33a X	
b Admissions policies?	33b X	
c Employment of faculty or administrative staff?	33c X	
d Scholarships or other financial assistance? (See instructions.)	33d X	
e Educational policies?	33e X	
f Use of facilities?	33f X	
g Athletic programs?	33g X	
h Other extracurricular activities?	33h X	
If you answered "Yes" to any of the above, please explain. (If you need more space, attach a separate statement.)		
34a Does the organization receive any financial aid or assistance from a governmental agency?	34a X	
b Has the organization's right to such aid ever been revoked or suspended? If you answered "Yes" to either 34a or b, please explain using an attached statement.	34b X	
35 Does the organization certify that it has complied with the applicable requirements of sections 4.01 through 4.05 of Rev. Proc. 75-50, 1975-2 CB 587, covering racial nondiscrimination? If "No," attach an explanation. (See instructions for Part V.)	35 X	

Part VI-A Lobbying Expenditures by Nongovernmental Public Charities (see instructions)
 (To be completed **ONLY** by an eligible organization that filed Form 5768)

 Check here ☐ a ☐ If the organization belongs to an affiliated group (see instructions).
 Check here ☐ b ☐ If you checked a and "limited control" provisions apply (see instructions)

N/A

Limits on Lobbying Expenditures

("Expenditures" means amounts paid or incurred)

		(a) Affiliated group totals	(b) To be completed for ALL electing organizations
36	Total lobbying expenditures to influence public opinion (grassroots lobbying)	36	
37	Total lobbying expenditures to influence a legislative body (direct lobbying)	37	
38	Total lobbying expenditures (add lines 36 and 37)	38	
39	Other exempt purpose expenditures (see Part VI-A instructions)	39	
40	Total exempt purpose expenditures (add lines 38 and 39) (see instructions)	40	
41	Lobbying nontaxable amount. Enter the amount from the following table—		
	If the amount on line 40 is—		The lobbying nontaxable amount is—
	Not over \$500,000		20% of the amount on line 40
	Over \$500,000 but not over \$1,000,000		\$100,000 plus 15% of the excess over \$500,000
	Over \$1,000,000 but not over \$1,500,000		\$175,000 plus 10% of the excess over \$1,000,000
	Over \$1,500,000 but not over \$17,000,000		\$225,000 plus 5% of the excess over \$1,500,000
	Over \$17,000,000		\$1,000,000
42	Grassroots nontaxable amount (enter 25% of line 41)	42	
43	Subtract line 42 from line 36. Enter -0- if line 42 is more than line 36	43	
44	Subtract line 41 from line 38. Enter -0- if line 41 is more than line 38	44	

Caution: File Form 4720 if there is an amount on either line 43 or line 44.

4-Year Averaging Period Under Section 501(h)

 (Some organizations that made a section 501(h) election do not have to complete all of the five columns below.
 See the instructions for lines 45-50 for details.)

Calendar year (or fiscal year beginning in) ▶	Lobbying Expenditures During 4-Year Averaging Period				
	(a) 1992	(b) 1991	(c) 1990	(d) 1989	(e) Total
45 Lobbying nontaxable amount (see instructions)					
46 Lobbying ceiling amount (150% of line 45(e))					
47 Total lobbying expenditures (see instructions)					
48 Grassroots nontaxable amount (see instructions)					
49 Grassroots ceiling amount (150% of line 48(e))					
50 Grassroots lobbying expenditures (see instructions)					

Part VI-B Lobbying Activity by Nongovernmental Public Charities
 (For reporting by organizations that did not complete Part VI-A)

N/A

During the year, did the organization attempt to influence national, state or local legislation, including any attempt to influence public opinion on a legislative matter or referendum, through the use of:

	Yes	No	Amount
a Volunteers			
b Paid staff or management (include compensation in expenses reported on lines c through h)			
c Media advertisements			
d Mailings to members, legislators, or the public			
e Publications or published or broadcast statements			
f Grants to other organizations for lobbying purposes			
g Direct contact with legislators, their staffs, government officials, or a legislative body			
h Rallies, demonstrations, seminars, conventions, speeches, lectures, or any other means			
i Total lobbying expenditures (add lines c through h)			

If "Yes" to any of the above, also attach a statement giving a detailed description of the lobbying activities.

51 Did the reporting organization directly or indirectly engage in any of the following with any other organization described in section 501(c) of the Code (other than section 501(c)(3) organizations) or in section 527, relating to political organizations?

- | | Yes | No |
|---|-----|----|
| a. Transfers from the reporting organization to a noncharitable exempt organization of: | | |

- | | Yes | No |
|--|-----|----|
| a Transfers from the reporting organization to a noncharitable exempt organization of: | | |

- | | | |
|----------|--------|---|
| (i) Cash | 51a(i) | X |
|----------|--------|---|

- | | | |
|-------------------|-------|---|
| (ii) Other assets | a(ii) | X |
|-------------------|-------|---|

- | | | | |
|------------------------|--|--|--|
| b. Other Transactions: | | | |
|------------------------|--|--|--|

- | | | |
|--|------|---|
| (i) Sales of assets to a noncharitable exempt organization | b(1) | X |
|--|------|---|

- | | | | |
|---|-------|--|---|
| (i) Sales of assets to a noncharitable exempt organization | | | |
| (ii) Purchases of assets from a noncharitable exempt organization | b(ii) | | X |

- | | | |
|---|--------|---|
| (ii) Purchases of assets from a noncharitable exempt organization | | |
| (iii) Rental of facilities or equipment | b(iii) | X |

- | | | | |
|--|-------|--|---|
| (iv) Rental of facilities or equipment | | | |
| (v) Reimbursement arrangements | b(iv) | | X |

- | | | | |
|---------------------------------|--|--|---|
| (iv) Reimbursement arrangements | | | |
| (a) Loan or loan guarantee | | | X |

- | | | | |
|---|-------|--|---|
| (v) Loans or loan guarantees | a(v) | | X |
| (vi) Performance of services or membership or fundraising solicitations | b(vi) | | X |

- | | | | |
|--|-------|--|---|
| (vi) Performance of services or membership or fundraising solicitations | 5(vi) | | X |
| Other information, equipment, mailing lists or other assets, or paid employees | 6 | | X |

- c. Sharing of facilities, equipment, mailing lists or other assets, or paid employees 6

- d If the answer to any of the above is "Yes," complete the following schedule. The "Amount involved" column below should always indicate the fair market value of the goods, other assets, or services given by the reporting organization. If the organization received less than fair

- the fair market value of the goods, other assets, or services given by the reporting organization. If the organization received less than fair market value in any transaction or sharing arrangement, indicate in column (d) the value of the goods, other assets, or services received.

[illegible]

- 52a Is the organization directly or indirectly affiliated with, or related to, one or more tax-exempt organizations

- described in section 501(c) of the Code (other than section 501(c)(3)) or in section 527? ☐ Yes ☒ No

- b If "Yes," complete the following schedule.

[illegible]

CASE CFacts:

Unnamed Health Care System, Inc. (System) operates Unnamed Hospital (Hospital), a 300-bed urban hospital. Hospital maintains an emergency room open to all, regardless of ability to pay. Hospital also operates two satellite clinics in outlying suburban areas. Hospital is the general partner in two limited partnerships that own medical office buildings adjacent to the satellite clinics. The limited partners of these partnerships are all physicians on the medical staff of Hospital.

Hospital has been recognized by the Service as an exclusively charitable organization under section 501(c)(3) and as a public charity described in section 170(b)(1)(a)(iii). Hospital has assets of approximately \$100 million and outstanding liabilities of approximately \$25 million, including \$15 million in tax exempt bonds. Hospital's board of directors consists of fourteen members: its chief executive officer (CEO), its chief financial officer (CFO), five physicians, and seven civic leaders who represent the community at large. The five physicians represent the private medical groups responsible for the greatest number of Hospital inpatient admissions over the past several years.

Hospital paid \$8 million to acquire from a corporation controlled by Hospital's chief of surgery all of the assets of a freestanding ambulatory surgery center. Hospital promptly closed the facility, which had been located two miles from Hospital and had been its main competitor. Hospital has been unable to find a buyer or tenant for the building, which remains vacant. The corporation controlled by the chief of surgery paid only \$3.8 million for the facilities and equipment two years earlier.

Hospital purchased the private medical practices of two physicians located on the edge of its service area for \$250,000 each. In one case, the selling physician retired, and Hospital resold that practice to a newly recruited physician for \$125,000, paid in the form of a 5 year, non-interest bearing note. Hospital entered into a ten-year contract with the selling physician of the other medical practice, which obligated the physician to provide all medical services needed to operate the practice. Hospital agreed to pay the physician \$150,000, plus 65% of the amount by which gross revenues from the practice exceed \$200,000. In the year prior to Hospital's purchase of the practice, the physician had net practice income of \$90,000.

Hospital agreed to re-finance the mortgages on the personal residences of the CEO and CFO at interest rates below prevailing market rates. At the same time, the board of directors authorized: 1) an increase in the annual salary of the CEO from \$400,000 to \$600,000; 2) the lease by the Hospital of all vacant space in both joint venture medical office buildings at full market rates (although Hospital has no current need for the space); and (3) a recruiting program for new staff physicians to guarantee each recruit a minimum net private practice income of \$200,000 per year for two years. Any amounts payable under the income guarantee would be structured as non-interest bearing loans, which would be forgiven if the recruit remained on staff for two years. Most new recruits will be encouraged to accept employment with existing medical groups made up of Hospital medical staff members (these groups have recently been spending an average of \$50,000 to recruit each new physician and had approached Hospital for help). Other recruits will establish their own private practices and will be offered below-market rent in System medical office buildings.

Issues:**A. Hospital Lease of Space in Medical Office Buildings Owned by Partnerships**

Hospital's lease of the vacant medical office building space, even though it has no current need for the space, may be a means of ensuring the profitability of the joint ventures that own the buildings. This arrangement could have the effect of causing Hospital to bear any losses generated by low occupancy, to the benefit of the staff physicians who are limited partners in the joint ventures. Therefore, unless Hospital can demonstrate that the arrangement fulfills its exempt purpose, the arrangement could represent inurement or private benefit.

B. Board of Directors**1. Physician and management participation.**

The constitution of Hospital's board of directors--in particular, the fact that half of the members are physicians or officers of Hospital--is one factor that we would consider in determining whether Hospital meets the community benefit standard derived from Revenue Ruling 69-545. In general, the greater the participation in board decisions by "insiders," the less likely those decisions will represent the interests of the community at large.

2. Are interested directors voting on matters affecting them?

We would also examine whether physicians and officers are voting on matters that affect them personally. For example, the physicians on the board may also be investors in the medical office building joint ventures, in which case they would have an interest in Hospital's lease of vacant office space. The physicians on the board could also benefit from Hospital's recruiting program. To the extent that board members who have a personal interest in a transaction participated in the board's approval of the transaction, that approval would carry less weight as evidence of the legitimacy of the transaction.

C. Purchase of Ambulatory Surgery Center

Payment by Hospital of a price in excess of the fair market value of the ambulatory surgery center would result in inurement or private benefit. The fact that the seller purchased the center only two years earlier for less than half the amount paid by Hospital suggests that the price paid by Hospital could be excessive. Further, the fact that the seller is controlled by Hospital's chief of surgery suggests that the bargaining leading to the sale may not have been entirely at arm's length. We would ask Hospital if an appraisal was made in connection with the transaction and would ask an IRS valuation expert to review any such appraisal.

D. Mortgage Re-financing

We would consider the value of the beneficial terms of the loans made by Hospital to its CEO and CFO in assessing the reasonableness of the compensation paid by Hospital to these officers.

E. Increase of CEO's Salary

The reasonableness of the CEO's increased salary would be determined based on the amount similar hospitals pay to their chief executives. Approval of the salary by an independent board would weigh in favor of a finding of reasonableness. In this case, however, we would consider whether the CEO participated in

the determination of his own salary, by voting or otherwise attempting to influence the board. The payment by Hospital to CEO of an unreasonable amount of total compensation would be inurement.

F. Recruiting Program

Hospital may be assuming recruiting costs that are more properly business expenses of the private medical group practices. Expenditures by Hospital for the benefit of the staff physicians who own these practices may constitute inurement or private benefit.

G. Acquisition of Private Practices

The reasonableness of the purchase price paid for the medical practices is a question of fact. In addressing this question, we would consider whether the price was arrived at by arm's length bargaining and was supported by an independent appraisal. We might ask Service experts to prepare a valuation. Payment by Hospital of an excessive purchase price would constitute inurement or private benefit.

If the initial purchase price of \$250,000 was at fair market value, the price at which one of the practices was resold, \$125,000, would appear to be below fair market value. If Hospital resold the practice at a bargain price as a recruiting device, we would take into account the bargain element, as well as the benefit of the interest-free loan of the purchase price, in assessing the reasonableness of the purchasing physician's total compensation.

In the case in which the selling physician became a Hospital contractor, we would examine the terms of the service contract carefully to determine whether the fees paid to the physician were excessive. A number of facts suggest that this might be the case. The physician will earn over 50% more as a contractor than he did in private practice. Further, he has an exclusive ten-year contract and an unlimited potential to share in the gross income of the practice gross. Nonetheless, these factors are not determinative: the reasonableness of the compensation depends on all the relevant facts and circumstances.

Form **990****Return of Organization Exempt From Income Tax**

Under section 501(c) of the Internal Revenue Code (except black lung benefit trust or private foundation) or section 4947(a)(1) charitable trust

OMB No. 1545-0047

1992This Form is
Open to Public
InspectionDepartment of the Treasury
Internal Revenue Service

Note: The organization may have to use a copy of this return to satisfy state reporting requirements.

A For the calendar year 1992, or fiscal year beginning , 1992, and ending , 19	
Please use IRS label or print or type. See Specific Instructions.	B Name of organization <u>Unamed Health Care System Inc.</u>
	Number and street (or P.O. box if mail is not delivered to street address) Room/suite <u>3333 Main Street</u>
	City, town, or post office, state, and ZIP code <u>Utopia PA 11111</u>
	C Employer identification number <u>95 1234567</u>
D State registration number	
E If address changed, check box <input type="checkbox"/>	
F Check type of organization—Exempt under section <input checked="" type="checkbox"/> 501(c) 3 (insert number). OR <input type="checkbox"/> section 4947(a)(1) charitable trust	
G If exemption application pending, check box <input type="checkbox"/>	
H(a) Is this a group return filed for affiliates? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	
(b) If "Yes," enter the number of affiliates for which this return is filed: <input type="checkbox"/>	
I If either box in H is checked "Yes," enter four-digit group exemption number (GEN) <input type="checkbox"/>	
J Accounting method: <input type="checkbox"/> Cash <input checked="" type="checkbox"/> Accrual <input type="checkbox"/> Other (specify) <input type="checkbox"/>	
(c) Is this a separate return filed by an organization covered by a group ruling? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	
K Check here <input type="checkbox"/> if the organization's gross receipts are normally not more than \$25,000. The organization need not file a return with the IRS, but if it received a Form 990 Package in the mail, it should file a return without financial data. Some states require a complete return.	

Note: Form 990EZ may be used by organizations with gross receipts less than \$100,000 and total assets less than \$250,000 at end of year.

Part I Statement of Revenue, Expenses, and Changes in Net Assets or Fund Balances

Revenue	1 Contributions, gifts, grants, and similar amounts received:			
	a Direct public support	1a	3,000,000	
	b Indirect public support	1b	100,000	
	c Government grants	1c	900,000	
	d Total (add lines 1a through 1c) (attach schedule—see instructions)	1d	4,000,000	
	2 Program service revenue (from Part VII, line 93)	2	90,000,000	
	3 Membership dues and assessments (see instructions)	3		
	4 Interest on savings and temporary cash investments	4	1,000,000	
	5 Dividends and interest from securities	5	2,000,000	
	6a Gross rents	6a		
b Less: rental expenses	6b			
c Net rental income or (loss)	6c			
7 Other investment income (describe <input type="checkbox"/>)	7			
Expenses	8a Gross amount from sale of assets other than inventory	(A) Securities	8a	
	b Less: cost or other basis and sales expenses	1,500,000	8b	
	c Gain or (loss) (attach schedule)	500,000	8c	
	d Net gain or (loss) (combine line 8c, columns (A) and (B))	8d	500,000	
	9 Special fundraising events and activities (attach schedule—see instructions):			
	a Gross revenue (not including \$ of contributions reported on line 1a)	9a		
	b Less: direct expenses	9b		
	c Net income	9c		
	10a Gross sales less returns and allowances	10a		
	b Less: cost of goods sold	10b		
Net Assets	c Gross profit or (loss) (attach schedule)	10c		
	11 Other revenue (from Part VII, line 103)	11	500,000	
	12 Total revenue (add lines 1d, 2, 3, 4, 5, 6c, 7, 8d, 9c, 10c, and 11)	12	97,000,000	
	13 Program services (from line 44, column (B)) (see instructions)	13	85,000,000	
	14 Management and general (from line 44, column (C)) (see instructions)	14	7,800,000	
	15 Fundraising (from line 44, column (D)) (see instructions)	15	200,000	
	16 Payments to affiliates (attach schedule—see instructions)	16		
	17 Total expenses (add lines 16 and 44, column (A))	17	93,000,000	
	18 Excess or (deficit) for the year (subtract line 17 from line 12)	18	4,000,000	
	19 Net assets or fund balances at beginning of year (from line 74, column (A))	19	72,500,000	
20 Other changes in net assets or fund balances (attach explanation)	20			
21 Net assets or fund balances at end of year (combine lines 18, 19, and 20)	21	76,500,000		

For Paperwork Reduction Act Notice, see page 1 of the separate instructions.

Cat No 11282Y

Form 990 (1992)

Part II Statement of Functional Expenses

All organizations must complete column (A). Columns (B), (C), and (D) are required for section 501(c)(3) and (4) organizations and 4947(a)(1) charitable trusts but optional for others. (See instructions.)

Do not include amounts reported on line 6b, 8b, 9b, 10b, or 16 of Part I.		(A) Total	(B) Program services	(C) Management and general	(D) Fundraising
22	Grants and allocations (attach schedule)	22			
23	Specific assistance to individuals (attach schedule)	23			
24	Benefits paid to or for members (attach schedule)	24			
25	Compensation of officers, directors, etc.	25	1,400,000	300,000	1,000,000
26	Other salaries and wages	26	45,000,000	41,000,000	3,950,000
27	Pension plan contributions	27	1,000,000	900,000	90,000
28	Other employee benefits	28	4,500,000	4,100,000	395,000
29	Payroll taxes	29	4,000,000	3,695,000	305,000
30	Professional fundraising fees	30			
31	Accounting fees	31	100,000	80,000	20,000
32	Legal fees	32	25,000		25,000
33	Supplies	33	12,000,000	11,000,000	1,000,000
34	Telephone	34	300,000	200,000	100,000
35	Postage and shipping	35			
36	Occupancy	36	200,000	180,000	20,000
37	Equipment rental and maintenance	37	100,000	100,000	
38	Printing and publications	38	400,000	350,000	50,000
39	Travel	39	700,000	600,000	100,000
40	Conferences, conventions, and meetings	40			
41	Interest	41	2,500,000	2,000,000	500,000
42	Depreciation, depletion, etc. (attach schedule)	42	2,000,000	1,800,000	200,000
43	Other expenses (itemize): a	43a			
	b SEE ATTACHED	43b			
	c SCHEDULE	43c	18,775,000	18,695,000	50,000
	d	43d			30,000
	e	43e			
	f	43f			
44	Total functional expenses (add lines 22 through 43). Organizations completing columns (B)-(D), carry these totals to lines 13-15.	44	93,000,000	85,000,000	7,800,000

Reporting of Joint Costs.—Did you report in column (B) (Program services) any joint costs from a combined educational campaign and fundraising solicitation? ☐ Yes ☒ No

(i) "Yes," enter (i) the aggregate amount of these joint costs \$ _____; (ii) the amount allocated to program services \$ _____; (iii) the amount allocated to management and general \$ _____; and (iv) the amount allocated to fundraising \$ _____.

Part III Statement of Program Service Accomplishments (See instructions.)

Describe what was achieved in carrying out the organization's exempt purposes. Fully describe the services provided, the number of persons benefited, or other relevant information for each program title. Section 501(c)(3) and (4) organizations and section 4947(a)(1) charitable trusts must also enter the amount of grants and allocations to others.

		Expenses (Required for 501(c)(3) and (4) organizations and 4947(a)(1) trusts; optional for others.)	
a	Unnamed Health Care System operates Unnamed Hospital, a 300 bed acute care hospital that provides medical care and related health services to the general public. Patients services provided in 1992 included the following: (Grants and allocations \$ _____)		
b	Inpatient acute care — 14,500 Admissions, 102,000 patient days Emergency room — 46,000 Visits Outpatient clinics — 30,000 Visits (Grants and allocations \$ _____)		85,000,000
c	Home health care — 60,000 visits (Grants and allocations \$ _____)		
d	(Grants and allocations \$ _____)		
e	Other program services (attach schedule) (Grants and allocations \$ _____)		
f	Total (add lines a through e) (should equal line 44, column (B))		

Part IV Balance Sheets

Note: Where required, attached schedules and amounts within the description column should be for end-of-year amounts only.		(A) Beginning of year	(B) End of year
Assets			
45	Cash—non-interest-bearing	400,000	45 200,000
46	Savings and temporary cash investments	18,000,000	46 15,000,000
47a	Accounts receivable	12,000,000	47c 13,000,000
b	Less: allowance for doubtful accounts		
47b			
47c			
48a	Pledges receivable		
b	Less: allowance for doubtful accounts		
48b			
48c			
49	Grants receivable		
50	Receivables due from officers, directors, trustees, and key employees (attach schedule)	1,100,000	50 1,000,000
51a	Other notes and loans receivable (attach schedule)	125,000	51c 125,000
b	Less: allowance for doubtful accounts	- 0 -	
51b			
52	Inventories for sale or use	1,000,000	52 1,000,000
53	Prepaid expenses and deferred charges	2,500,000	53 3,000,000
54	Investments—securities (attach schedule)	15,500,000	54 14,000,000
55a	Investments—land, buildings, and equipment: basis	8,000,000	
b	Less: accumulated depreciation (attach schedule)	200,000	
55b			
55c			
56	Investments—other (attach schedule)	- 0 -	56 7,800,000
57a	Land, buildings, and equipment: basis	70,000,000	
b	Less: accumulated depreciation (attach schedule)	20,000,000	
57b			
57c			
58	Other assets (describe ► <i>Medical Partnerships</i>)	5,000,000	58 6,000,000
59	Total assets (add lines 45 through 58) (must equal line 75)	97,500,000	59 102,000,000
Liabilities			
60	Accounts payable and accrued expenses	2,000,000	60 3,500,000
61	Grants payable		61
62	Support and revenue designated for future periods (attach schedule)		62
63	Loans from officers, directors, trustees, and key employees (attach schedule)		63
64	Mortgages and other notes payable (attach schedule)	22,000,000	64 20,000,000
65	Other liabilities (describe ► <i>Deferred compensation est.</i>)	1,000,000	65 2,000,000
66	Total liabilities (add lines 60 through 65) <i>malpractice claims</i>	25,000,000	66 25,500,000
Fund Balances or Net Assets			
Organizations that use fund accounting, check here ► <input checked="" type="checkbox"/> and complete lines 67 through 70 and lines 74 and 75 (see instructions)			
67a	Current unrestricted fund	36,500,000	67a 42,500,000
b	Current restricted fund		67b
68	Land, buildings, and equipment fund	26,000,000	68 24,000,000
69	Endowment fund	10,000,000	69 10,000,000
70	Other funds (describe ►)		70
Organizations that do not use fund accounting, check here ► <input type="checkbox"/> and complete lines 71 through 75 (see instructions).			
71	Capital stock or trust principal		71
72	Paid-in or capital surplus		72
73	Retained earnings or accumulated income		73
74	Total fund balances or net assets (add lines 67a through 70 OR lines 71 through 73: column (A) must equal line 19 and column (B) must equal line 21)	72,500,000	74 76,500,000
75	Total liabilities and fund balances/net assets (add lines 66 and 74)	97,500,000	75 102,000,000

Form 990 is available for public inspection and, for some people, serves as the primary or sole source of information about a particular organization. How the public perceives an organization in such cases may be determined by the information presented on its return. Therefore, please make sure the return is complete and accurate and fully describes the organization's programs and accomplishments.

Part V List of Officers, Directors, Trustees, and Key Employees (List each one even if not compensated. See instructions.)

(A) Name and address	(B) Title and average hours per week devoted to position	(C) Compensation (if not paid, enter -0-)	(D) Contributions to employee benefit plans	(E) Expense account and other allowances
John Doe 1111 Anystreet No Name 99999 Utopia, PA 11111	President CEO	600,000	50,000	
Richard Roe Utopia, PA 11111	V.P. + CFO	200,000	20,000	
Mary Foe Utopia, PA 11111	V.P. MEDICAL AFFAIRS	200,000	20,000	
Bill Hoo Utopia, PA 11111	V.P. NURSING	150,000	15,000	

Did any officer, director, trustee, or key employee receive aggregate compensation of more than \$100,000 from your organization and all related organizations, of which more than \$10,000 was provided by the related organizations? ☐ Yes ☒ No
If "Yes," attach schedule (see instructions).

Part VI Other Information

Note: Section 501(c)(3) organizations and section 4947(a)(1) trusts must also complete and attach Schedule A (Form 990).

	Yes	No
76 Did the organization engage in any activity not previously reported to the Internal Revenue Service? . . . If "Yes," attach a detailed description of each activity.	76	X
77 Were any changes made in the organizing or governing documents, but not reported to the IRS? . . . If "Yes," attach a conformed copy of the changes.	77	X
78a Did the organization have unrelated business gross income of \$1,000 or more during the year covered by this return?	78a	X
b If "Yes," has it filed a tax return on Form 990-T, Exempt Organization Business Income Tax Return, for this year?	78b	N/A
c At any time during the year, did the organization own a 50% or greater interest in a taxable corporation or partnership? If "Yes," complete Part IX.	78c	X
79 Was there a liquidation, dissolution, termination, or substantial contraction during the year? (See instructions.) If "Yes," attach a statement as described in the instructions.	79	X
80a Is the organization related (other than by association with a statewide or nationwide organization) through common membership, governing bodies, trustees, officers, etc., to any other exempt or non-exempt organization? (See instructions.) b If "Yes," enter the name of the organization . . . and check whether it is <input type="checkbox"/> exempt OR <input type="checkbox"/> nonexempt.	80a	X
81a Enter amount of political expenditures, direct or indirect, as described in the instructions . . . [81a] -0-	81a	-0-
b Did the organization file Form 1120-POL, U.S. Income Tax Return for Certain Political Organizations, for this year?	81b	X
82a Did the organization receive donated services or the use of materials, equipment, or facilities at no charge or at substantially less than fair rental value? b If "Yes," you may indicate the value of these items here. Do not include this amount as revenue in Part I or as an expense in Part II. See instructions for reporting in Part III . . . [82b] N/A	82a	X
83a Did anyone request to see either the organization's annual return or exemption application (or both)?	83a	X
b If "Yes," did the organization comply as described in the instructions? (See General Instruction L.)	83b	X
84a Did the organization solicit any contributions or gifts that were not tax deductible? b If "Yes," did the organization include with every solicitation an express statement that such contributions or gifts were not tax deductible? (See General Instruction M.)	84a	X
84b	N/A	
85a Section 501(c)(5) or (6) organizations.—Did the organization spend any amounts in attempts to influence public opinion about legislative matters or referendums? (See instructions and Regulations section 1.162-20(c).) b If "Yes," enter the total amount spent for this purpose . . . [85b] N/A	85a	N/A
85b	N/A	
86 Section 501(c)(7) organizations.—Enter: a Initiation fees and capital contributions included on line 12 . . . [86a] N/A b Gross receipts, included on line 12, for public use of club facilities (see instructions) . . . [86b] N/A c Does the club's governing instrument or any written policy statement provide for discrimination against any person because of race, color, or religion? (If "Yes," attach statement. See instructions.)	86a	N/A
86b	N/A	
86c	N/A	
87 Section 501(c)(12) organizations.—Enter amount of: a Gross income received from members or shareholders . . . [87a] N/A b Gross income received from other sources. (Do not net amounts due or paid to other sources against amounts due or received from them.) . . . [87b] N/A	87a	N/A
87b	N/A	
88 Public interest law firms.—Attach information described in the instructions.		
89 List the states with which a copy of this return is filed . . .		
90 During this tax year did the organization maintain any part of its accounting / tax records on a computerized system?	90	X
91 The books are in care of . . . Telephone no. . . () . . . Located at . . . ZIP code . . .		
92 Section 4947(a)(1) charitable trusts filing Form 990 in lieu of Form 1041, U.S. Fiduciary Income Tax Return, should check here <input type="checkbox"/> and enter the amount of tax-exempt interest received or accrued during the tax year . . . [92]		

Part VII Analysis of Income-Producing Activities

Enter gross amounts unless otherwise indicated.

93 Program service revenue:(a) Patient Service Revenues

- (b) _____
 (c) _____
 (d) _____
 (e) _____
 (f) _____
 (g) Fees from government agencies

94 Membership dues and assessments**95 Interest on savings and temporary cash investments****96 Dividends and interest from securities****97 Net rental income or (loss) from real estate:**

(a) debt-financed property

(b) not debt-financed property

98 Net rental income or (loss) from personal property**99 Other investment income****100 Gain or (loss) from sales of assets other than inventory****101 Net income from special fundraising events****102 Gross profit or (loss) from sales of inventory****103 Other revenue: (a) Partnership Income**

(b) _____

(c) _____

(d) _____

(e) _____

104 Subtotal (add columns (b), (d), and (e))**105 TOTAL (add line 104, columns (b), (d), and (e))**

Note: (Line 105 plus line 10, Part I, should equal the amount on line 12, Part I.)

Part VIII Relationship of Activities to the Accomplishment of Exempt Purposes

Line No. Explain how each activity for which income is reported in column (e) of Part VII contributed importantly to the accomplishment of the organization's exempt purposes (other than by providing funds for such purposes). (See instructions.)

93(a) Related to our exempt purpose of providing medical care to inpatients,outpatients, and at-home patients103(a) Income from partnerships owning medical office building adjacentto hospital facilitiesPlease
Sign
Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than officer) is based on all information of which preparer has any knowledge.

Richard Roe

Signature of officer

1/5/93

Date

V.P. CFO

Title

Paid
Preparer's
Use OnlyPreparer's
signatureFirm's name (or
yours if self-employed)
and address

Date

ZIP code

Check if
self-employed ☐

SCHEDULE A
(Form 990)

 Department of the Treasury
 Internal Revenue Service
 Name

Organization Exempt Under Section 501(c)(3)
 (Except Private Foundation), 501(e), 501(f), 501(k), or Section 4947(a)(1) Charitable Trust
 Supplementary Information

▶ Attach to Form 990 for Form 990EZ.

OMB No. 1545-0047

1992

Employer identification number

Part I Compensation of the Five Highest Paid Employees Other Than Officers, Directors, and Trustees
 (See specific instructions.) (List each one. If there are none, enter "None.")

(a) Name and address of employees paid more than \$30,000	(b) Title and average hours per week devoted to position	(c) Compensation	(d) Contributions to employee benefit plans	(e) Expense account and other allowances
DR. A	Director, Surgery	200,000	15,000	-0-
DR. B	Director, Radiology	190,000	14,000	-0-
DR. C	Director, Lab. Svcs.	180,000	13,000	-0-
DR. D	Director, Home Health Svcs.	170,000	12,000	-0-
DR. E	Director, Emergency Svcs.	160,000	11,000	-0-
Total number of other employees paid over \$30,000 ▶	450			

Part II Compensation of the Five Highest Paid Persons for Professional Services
 (See specific instructions.) (List each one. If there are none, enter "None.")

(a) Name and address of persons paid more than \$30,000	(b) Type of service	(c) Compensation
ABC Systems	Data Processing	1,000,000
DSF Anesthesia	Anesthesia Svcs.	800,000
GHI Laundry	Linen Service	700,000
JKL Cardiology	Medical	650,000
MNO Security	Security	600,000
Total number of others receiving over \$30,000 for professional services ▶	20	

Part III Statements About Activities

	Yes	No
1 During the year, has the organization attempted to influence national, state, or local legislation, including any attempt to influence public opinion on a legislative matter or referendum? If "Yes," enter the total expenses paid or incurred in connection with the lobbying activities. \$ _____ Organizations that made an election under section 501(h) by filing Form 5768 must complete Part VI-A. Other organizations checking "Yes," must complete Part VI-B AND attach a statement giving a detailed description of the lobbying activities	1	X
2 During the year, has the organization, either directly or indirectly, engaged in any of the following acts with any of its trustees, directors, principal officers, or creators, or with any taxable organization or corporation with which any such person is affiliated as an officer, director, trustee, majority owner, or principal beneficiary:		
a Sale, exchange, or leasing of property?	2a	X
b Lending of money or other extension of credit?	2b	X
c Furnishing of goods, services, or facilities?	2c	X
d Payment of compensation for payment or reimbursement of expenses if more than \$1,000?	2d	X
e Transfer of any part of its income or assets? If the answer to any question is "Yes," attach a detailed statement explaining the transactions	2e	
3 Does the organization make grants for scholarships, fellowships, student loans, etc.?	3	X
4 Attach a statement explaining how the organization determines that individuals or organizations receiving grants or loans from it in furtherance of its charitable programs qualify to receive payments. (See specific instructions.)		

Part IV Reason for Non-Private Foundation Status (See instructions for definitions.)

The organization is not a private foundation because it is (please check only ONE applicable box):

- 5 ☐ A church, convention of churches, or association of churches. Section 170(b)(1)(A)(i).
- 6 ☐ A school. Section 170(b)(1)(A)(ii). (Also complete Part V, page 3.)
- 7 ☒ A hospital or a cooperative hospital service organization. Section 170(b)(1)(A)(iii).
- 8 ☐ A Federal, state, or local government or governmental unit. Section 170(b)(1)(A)(v).
- 9 ☐ A medical research organization operated in conjunction with a hospital. Section 170(b)(1)(A)(iii). Enter name, city, and state of hospital ►
- 10 ☐ An organization operated for the benefit of a college or university owned or operated by a governmental unit. Section 170(b)(1)(A)(iv). (Also complete Support Schedule.)
- 11a ☐ An organization that normally receives a substantial part of its support from a governmental unit or from the general public. Section 170(b)(1)(A)(vi). (Also complete Support Schedule.)
- 11b ☐ A community trust. Section 170(b)(1)(A)(vi). (Also complete Support Schedule.)
- 12 ☐ An organization that normally receives: (a) no more than 1/5 of its support from gross investment income and unrelated business taxable income (less section 511 tax) from businesses acquired by the organization after June 30, 1975, and (b) more than 1/5 of its support from contributions, membership fees, and gross receipts from activities related to its charitable, etc., functions—subject to certain exceptions. See section 509(a)(2). (Also complete Support Schedule.)
- 13 ☐ An organization that is not controlled by any disqualified persons (other than foundation managers) and supports organizations described in: (1) boxes 5 through 12 above; or (2) section 501(c)(4), (5), or (6), if they meet the test of section 509(a)(2). (See section 509(a)(3).)

Provide the following information about the supported organizations. (See instructions for Part IV, box 13.)

(a) Name(s) of supported organization(s)	(b) Box number from above

- 14 ☐ An organization organized and operated to test for public safety. Section 509(a)(4). (See specific instructions.)

Support Schedule (Complete only if you checked box 10, 11, or 12 above.) Use cash method of accounting.

Calendar year (or fiscal year beginning in) ►	(a) 1991	(b) 1990	(c) 1989	(d) 1988	(e) Total
15 Gifts, grants, and contributions received. (Do not include unusual grants. See line 28.)					
16 Membership fees received					
17 Gross receipts from admissions, merchandise sold or services performed, or furnishing of facilities in any activity that is not a business unrelated to the organization's charitable, etc., purpose					
18 Gross income from interest, dividends, amounts received from payments on securities loans (section 512(a)(5)), rents, royalties, and unrelated business taxable income (less section 511 taxes) from businesses acquired by the organization after June 30, 1975.					
19 Net income from unrelated business activities not included in line 18					
20 Tax revenues levied for the organization's benefit and either paid to it or expended on its behalf					
21 The value of services or facilities furnished to the organization by a governmental unit without charge. Do not include the value of services or facilities generally furnished to the public without charge.					
22 Other income. Attach schedule. Do not include gain or (loss) from sale of capital assets.					
23 Total of lines 15 through 22.					
24 Line 23 minus line 17.					
25 Enter 1% of line 23					
26 Organizations described in box 10 or 11:					
a Enter 2% of amount in column (e), line 24					
b Attach a list (not open to public inspection) showing the name of and amount contributed by each person (other than a governmental unit or publicly supported organization) whose total gifts for 1988 through 1991 exceeded the amount shown in line 26a. Enter the sum of all excess amounts here ►					

(Continued on page 3)

Part IV Support Schedule (continued) (Complete only if you checked box 10, 11, or 12 on page 2.)**27** Organizations described in box 12, page 2:

a Attach a list for amounts shown on lines 15, 16, and 17, showing the name of, and total amounts received in each year from, each "disqualified person," and enter the sum of such amounts for each year:

(1991) (1990) (1989) (1988)

b Attach a list showing, for 1988 through 1991, the name of, and amount included in line 17 for, each person (other than a "disqualified person") from whom the organization received more during that year than the larger of: (1) the amount on line 25 for the year; or (2) \$5,000. Include organizations described in boxes 5 through 11 as well as individuals. Enter the sum of these excess amounts for each year:

(1991) (1990) (1989) (1988)

28 For an organization described in box 10, 11, or 12, page 2, that received any unusual grants during 1988 through 1991, attach a list (not open to public inspection) for each year showing the name of the contributor, the date and amount of the grant, and a brief description of the nature of the grant. Do not include these grants in line 15. (See specific instructions.)**Part V** Private School Questionnaire

(To be completed ONLY by schools that checked box 6 in Part IV)

N/A

	Yes	No
29 Does the organization have a racially nondiscriminatory policy toward students by statement in its charter, bylaws, other governing instrument, or in a resolution of its governing body?	29	
30 Does the organization include a statement of its racially nondiscriminatory policy toward students in all its brochures, catalogues, and other written communications with the public dealing with student admissions, programs, and scholarships?	30	
31 Has the organization publicized its racially nondiscriminatory policy through newspaper or broadcast media during the period of solicitation for students, or during the registration period if it has no solicitation program, in a way that makes the policy known to all parts of the general community it serves? If "Yes," please describe; if "No," please explain. (If you need more space, attach a separate statement.)	31	
32 Does the organization maintain the following: a Records indicating the racial composition of the student body, faculty, and administrative staff?	32a	
b Records documenting that scholarships and other financial assistance are awarded on a racially nondiscriminatory basis?	32b	
c Copies of all catalogues, brochures, announcements, and other written communications to the public dealing with student admissions, programs, and scholarships?	32c	
d Copies of all material used by the organization or on its behalf to solicit contributions? If you answered "No" to any of the above, please explain. (If you need more space, attach a separate statement.)	32d	
33 Does the organization discriminate by race in any way with respect to: a Students' rights or privileges?	33a	
b Admissions policies?	33b	
c Employment of faculty or administrative staff?	33c	
d Scholarships or other financial assistance? (See instructions).	33d	
e Educational policies?	33e	
f Use of facilities?	33f	
g Athletic programs?	33g	
h Other extracurricular activities? If you answered "Yes" to any of the above, please explain. (If you need more space, attach a separate statement.)	33h	
34a Does the organization receive any financial aid or assistance from a governmental agency?	34a	
b Has the organization's right to such aid ever been revoked or suspended? If you answered "Yes" to either 34a or b, please explain using an attached statement	34b	
35 Does the organization certify that it has complied with the applicable requirements of sections 4 01 through 4 05 of Rev. Proc. 75-50, 1975-2 C.B. 587, covering racial nondiscrimination? If "No," attach an explanation. (See instructions for Part V.)	35	

Part VI-A Lobbying Expenditures by Electing Public Charities (see instructions)
(To be completed **ONLY** by an eligible organization that filed Form 5768)

N/A

Check here ☐ a ☐ If the organization belongs to an affiliated group (see instructions)
Check here ☐ b ☐ If you checked a and "limited control" provisions apply (see instructions).**Limits on Lobbying Expenditures**

("Expenditures" means amounts paid or incurred)

	(a) Affiliated group totals	(b) To be completed for ALL electing organizations
36 Total lobbying expenditures to influence public opinion (grassroots lobbying)	36	
37 Total lobbying expenditures to influence a legislative body (direct lobbying)	37	
38 Total lobbying expenditures (add lines 36 and 37)	38	
39 Other exempt purpose expenditures (see Part VI-A instructions)	39	
40 Total exempt purpose expenditures (add lines 38 and 39) (see instructions)	40	
41 Lobbying nontaxable amount. Enter the amount from the following table— If the amount on line 40 is— The lobbying nontaxable amount is— Not over \$500,000 20% of the amount on line 40 Over \$500,000 but not over \$1,000,000 . . . \$100,000 plus 15% of the excess over \$500,000 Over \$1,000,000 but not over \$1,500,000 . . . \$175,000 plus 10% of the excess over \$1,000,000 Over \$1,500,000 but not over \$17,000,000 . . . \$225,000 plus 5% of the excess over \$1,500,000 Over \$17,000,000 \$1,000,000	41	
42 Grassroots nontaxable amount (enter 25% of line 41)	42	
43 Subtract line 42 from line 36. Enter -0- if line 42 is more than line 36	43	
44 Subtract line 41 from line 38. Enter -0- if line 41 is more than line 38	44	

Caution: File Form 4720 if there is an amount on either line 43 or line 44

4-Year Averaging Period Under Section 501(h)(Some organizations that made a section 501(h) election do not have to complete all of the five columns below
See the instructions for lines 45–50 for details.)

Calendar year (or fiscal year beginning in) ▶	Lobbying Expenditures During 4-Year Averaging Period				
	(a) 1992	(b) 1991	(c) 1990	(d) 1989	(e) Total
45 Lobbying nontaxable amount (see instructions)					
46 Lobbying ceiling amount (150% of line 45(e))					
47 Total lobbying expenditures (see instructions)					
48 Grassroots nontaxable amount (see instructions)					
49 Grassroots ceiling amount (150% of line 48(e))					
50 Grassroots lobbying expenditures (see instructions)					

Part VI-B Lobbying Activity by Nonelecting Public Charities
(For reporting by organizations that did not complete Part VI-A.)

During the year, did the organization attempt to influence national, state or local legislation, including any attempt to influence public opinion on a legislative matter or referendum, through the use of:

	Yes	No	Amount
a Volunteers		X	
b Paid staff or management (include compensation in expenses reported on lines c through h)		X	
c Media advertisements		X	
d Mailings to members, legislators, or the public		X	
e Publications or published or broadcast statements		X	
f Grants to other organizations for lobbying purposes		X	
g Direct contact with legislators, their staffs, government officials, or a legislative body		X	
h Rallies, demonstrations, seminars, conventions, speeches, lectures, or any other means		X	
i Total lobbying expenditures (add lines c through h)			-0-

If "Yes" to any of the above, also attach a statement giving a detailed description of the lobbying activities.

Part VII Information Regarding Transfers To and Transactions and Relationships With Noncharitable Exempt Organizations

51 Did the reporting organization directly or indirectly engage in any of the following with any other organization described in section 501(c) of the Code (other than section 501(c)(3) organizations) or in section 527, relating to political organizations?

a Transfers from the reporting organization to a noncharitable exempt organization of:

		Yes	No
a	Transfers from the reporting organization to a noncharitable exempt organization of:	51a(i)	X
	(i) Cash		X
	(ii) Other assets	a(ii)	X
b	Other Transactions:		
	(i) Sales of assets to a noncharitable exempt organization	b(i)	X
	(ii) Purchases of assets from a noncharitable exempt organization	b(ii)	X
	(iii) Rental of facilities or equipment	b(iii)	X
	(iv) Reimbursement arrangements	b(iv)	X
	(v) Loans or loan guarantees	b(v)	X
	(vi) Performance of services or membership or fundraising solicitations	b(vi)	X
	(vii) Sharing of facilities, equipment, mailing lists or other assets, or paid employees	c	X

d. If the answer to any of the above is "Yes," complete the following schedule. The "Amount involved" column below should always indicate the fair market value of the goods, other assets, or services given by the reporting organization. If the organization received less than fair market value in any transaction or sharing arrangement, indicate in column (d) the value of the goods, other assets, or services received.

[illegible]

52a Is the organization directly or indirectly affiliated with, or related to, one or more tax-exempt organizations described in section 501(c) of the Code (other than section 501(c)(3)) or in section 527? ☐ Yes ☐ No

b If "Yes," complete the following schedule.

[illegible]

EXHIBIT E

STUDY OF PHYSICIAN RECRUITING INCENTIVES
IN THE PITTSBURGH DISTRICT

To attract physicians to their service areas, many hospitals offer financial incentives such as cash bonuses, guaranteed private practice incomes, below market loans, reduced or free office rent, moving expenses, and subsidized health or professional liability insurance. Revenue Agents in our Pittsburgh District studied the degree to which physicians in Western Pennsylvania reported these types of benefits on their individual tax returns. Depending on the final results of the study, it may be replicated in other districts.

During the initial phase of the study, agents contacted 17 rural and smaller city hospitals and requested copies of their recruiting or employment agreements with medical professionals recruited since January 1, 1986. The agents reviewed 165 recruiting or employment agreements and selected 34 individual taxpayers for examination.

In the second phase, begun in mid-1992, agents selected five urban hospitals and health care systems (most in Pittsburgh), and reviewed 280 recruiting or employment agreements. The agents selected seven individual taxpayers for examination.

Because the study focused on compliance by physicians rather than hospitals, it was not related to the Coordinated Examination Program for hospitals. The study was conducted by Examination Agents working for the District Director with support from the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations) and the Health Care Industry Specialist.

Both phases of the study involved the same process. Agents obtained Forms 1040 for the individual taxpayers to be examined. The agents determined from the hospital whether it provided any benefits includable in a physician's taxable income. The agents then ascertained whether the physician properly reported that income on his or her return. The agents asserted adjustments and, in appropriate cases, penalties and interest, when they determined that a physician did not properly report a benefit.

Results for the first phase have been mixed. Many physicians properly reported any incentives they received. Out of 34 taxpayers whose returns were examined in Phase 1 (with a total of 46 tax years or returns in question), 29 have had their examinations closed (covering 38 returns). Eight taxpayers (17 returns) had adjustments, but two (2 returns) were minor adjustments unrelated to the scope of the project. Thus, 6 out of 29 taxpayers (15 out of 38 returns) experienced significant adjustments due to their receipt of recruiting incentives, mostly due to unreported income subsidies or debt forgiveness. Thirteen taxpayers (13 returns) had no changes asserted. The total amount of tax and penalties asserted in Phase 1 to date is \$79,625. The largest amount of tax asserted for any one taxpayer was approximately \$46,000. This individual had not filed returns. Potential penalties on the hospitals for failure to report incentives on Forms W-2 or 1099 have not yet been developed.

Based on preliminary information, the level of compliance determined in the second phase appears to be higher. The large, urban hospitals involved in the second phase did not offer financial recruiting incentives as frequently as their rural or smaller city counterparts. The physicians appear to have treated correctly those incentives that the urban hospitals did provide.

CASE SUMMARIES
Hearings on IRS Compliance Activities Involving Section
501(c)(3) Public Charities

One of the cases we presented to the Subcommittee involves a section 501(c)(3) organization which provides health care in a clinic-type setting. In this case, the organization's board of directors is controlled by the CEO and a small number of persons with whom the CEO or the organization itself have substantial business dealings. The total compensation of the CEO exceeded \$1 million. The compensation package included a base salary; a substantial distribution from an executive compensation plan; and premium payments on several hundred thousand dollars of life insurance. The organization also made substantial credit card payments and cash disbursements for personal expenditures including liquor, china, perfume, crystal, theater, and airline tickets.

The organization at one time had substantial assets used in performance of its charitable purpose. It sold those assets and began purchasing physicians' private medical practices, in many cases at more than fair market value. The physicians and their staffs became employees of the tax exempt organization, which paid their salaries. The physicians operated out of the same locations, continuing to receive as much income as before the acquisition. The new organization did not provide the requisite community benefit described in Rev. Rul. 69-545. Issues under consideration include inurement, private benefit, and lack of charitable purpose. We are also reviewing whether the organization should have reported certain items on its Form 990.

Another case we described before the Subcommittee involved a large health care institution. In this case, the CEO received extraordinary compensation. The compensation package included a base salary; substantial bonuses; and generous perquisites and fringe benefits. The organization has an arrangement with its medical staff physicians under which they receive a base salary and a substantial percentage of fees collected with respect to their department without any cap on the amount an individual physician can receive. The organization also provides housing units for its employees. We are reviewing whether the housing is provided to employees at fair market value. We are also reviewing the deferred compensation arrangements, as well as the compensation related issues of inurement and private benefit.

Another case presented to the Subcommittee involves a section 501(c)(3) organization which provides educational services. In this case, the organization's chief executive officer is provided a significant compensation package including salary, deferred compensation, expense accounts, and loans, one of which is non-interest bearing. The CEO is also provided an expensive residence with the organization providing for all related costs of running the residence, including maid service.

The organization also provides, on a regular basis, market rate loans to a class of higher level employees.

Additional issues to be pursued include employment tax and unrelated business income tax.

Another case involves a 501 (c) (3) organization which provides care and service to the poor. In this case, a principal officer of the organization, along with relatives, had control over all aspects of the organization's activities, and engaged in numerous acts of inurement. Organization funds were used to pay for certain personal expenses such as: leasing of vehicles, educational expenses, vacations, home improvements, and rental of resort property. Further, the Service found that the minutes of one of the Board of Director's meetings were falsified. The principal officer and relatives resigned and the Board of Directors was reconstituted. The examination resulted in substantial tax and penalties against the officer for unreported income attributable to the value of the items previously cited. The organization's tax exempt status was not revoked since they have continued to provide care and service to the poor. No other enforcement actions were taken against the organization.

Another case presented to the Subcommittee involves a 501(c)(3) organization which is headed by a televangelist minister. In this case, the organization claimed that it was a "church" and therefore eligible for the benefits of the IRS's "church audit" procedures. Organization funds were used to pay for personal expenses such as: an extravagant reception and island vacation; a large down payment on the televangelist's home; and a second resort vacation. A substantial amount of compensation was not reported on the minister's individual tax return. Further, a subsidiary charity was engaged in schemes to make it appear that charitable programs were being accomplished. The IRS found that the organization acquired agricultural supplies for which the sale date had expired and then donated them to another charity claiming a "program service" activity on its Form 990 as providing a benefit to the public in excess of \$1 million. In one transaction, numerous other intervening exempt organizations were involved in declaring the very same agricultural supplies as in-kind contributions and program service expenditures. This type of activity would mislead donors into thinking that the organization's charitable work was greater than it actually was and that administrative costs were a smaller percentage of its program costs.

This case involves a television ministry. It raises a number of issues of inurement of income to insiders and of misuse of charitable assets for private benefit.

The ministry paid personal expenses for the minister including a home mortgage and household expenses without Board approval. In addition, the ministry paid membership dues to an expensive country club.

The ministry purchased additional homes for the minister, designated them as parsonages and paid substantial associated expenses.

The ministry charged substantial expenses to an "Accounts Receivable" account for the minister, and there have been no repayments by the minister, and these expenditures appear to be simply the payment of personal expenses.

In addition, the ministry paid a substantial sum for expenses on a house owned by a member of the minister's family. The house is occupied only a couple of months during the year. Neither the minister nor the family member lived in this house during the rest of the year.

Another case presented involves a Media Evangelist. There have been allegations that the organization raises large sums of money through fraudulent or misleading fundraising. The allegations further point out that although the organization solicits funds for special needs, it is careful to avoid asking for money for a specific purpose. The allegations also indicate that only a small part of the fund raising is used for charitable purposes.

Data developed provide indications that personal expenses of the officers and controlling individuals are being paid for by the organization. Issues under consideration include inurement and private benefit.

Another situation involves a number of exempt organizations that contracted with a for-profit fundraising organization. Nearly all of the organizations were viable exempt organizations with ongoing charitable programs. The exempt organizations were normally approached by the commercial fundraiser to encourage them to use their services as an exclusive provider of fundraising services. The fundraiser owned an exclusive or shared interest in the mailing list created by its efforts. The solicitation material contained a minimal amount of information concerning the exempt organization's charitable program. Virtually all money collected was absorbed by fundraiser fees with very little money being available for the exempt organizations' charitable programs. The true cost of the fundraising efforts was not readily discernible from the Form 990 since a substantial portion of the costs were allocated to and reported as program services rather than fundraising costs on the premise that the solicitation letters served the dual purpose of fundraising and education.

AUG 2 1992

VERSION A

Form **990**Department of the Treasury
Internal Revenue Service**Return of Organization Exempt From Income Tax**

Under section 501(c) of the Internal Revenue Code (except black lung benefit trust or private foundation) or section 4947(e)(1) charitable trust

OMB No. 1545-0047

1993This Form is
Open to Public
Inspection

Note: The organization may have to use a copy of this return to satisfy state reporting requirements.

A For the calendar year 1992, or fiscal year beginning

, 1992, and ending

, 19

Please use IRS label or print or type. See specific instructions.	B Name of organization		C Employer identification number	
	Number and street (or P.O. box if mail is not delivered to street address)		Room/suite	D State registration number
	City, town, or post office, state, and ZIP code			
	E If address changed, check box. <input type="checkbox"/> <input type="checkbox"/>			

F Check type of organization—Exempt under section ☐ 501(c) () (insert number),
OR ☐ section 4947(a)(1) charitable trustG If exemption application pending, check box ☐ ☐H(a) Is this a group return filed for affiliates? ☐ Yes ☐ NoI If either box in H is checked "Yes," enter four-digit group exemption number (GEN) ☐(b) If "Yes," enter the number of affiliates for which this return is filed. ☐J Accounting method: ☐ Cash ☐ Accrual(c) Is this a separate return filed by an organization covered by a group ruling? ☐ Yes ☐ No☐ Other (specify) ☐K Check here ☐ if the organization's gross receipts are normally not more than \$25,000. The organization need not file a return with the IRS; but if it received a Form 990 Package in the mail, it should file a return without financial data. Some states require a complete return.

Note: Form 990EZ may be used by organizations with gross receipts less than \$100,000 and total assets less than \$250,000 at end of year.

Part I Statement of Revenue, Expenses, and Changes in Net Assets or Fund Balances

Revenue	1 Contributions, gifts, grants, and similar amounts received:			
	a Direct public support	1a		
	b Indirect public support	1b		
	c Government grants	1c		
	d Total (add lines 1a through 1c) (attach schedule—see instructions).			1d
	(cash \$: noncash \$)			
	2 Program service revenue (from Part VII, line 93)			2
	3 Membership dues and assessments (see instructions)			3
	4 Interest on savings and temporary cash investments			4
	5 Dividends and interest from securities			5
	6a Gross rents	6a		
	b Less: rental expenses	6b		
c Net rental income or (loss)			6c	
7 Other investment income (describe <input type="checkbox"/>)			7	
8a Gross amount from sale of assets other than inventory	(A) Securities	(B) Other		
b Less: cost or other basis and sales expenses	8a	8b		
c Gain or (loss) (attach schedule)		8c		
d Net gain or (loss) (combine line 8c, columns (A) and (B))			8d	
9 Special fundraising events and activities (attach schedule—see instructions):				
a Gross revenue (not including \$ of contributions reported on line 1a)	9a			
b Less: direct expenses	9b			
c Net income			9c	
10a Gross sales less returns and allowances	10a			
b Less: cost of goods sold	10b			
c Gross profit or (loss) (attach schedule)			10c	
11 Other revenue (from Part VII, line 103)			11	
12 Total revenue (add lines 1d, 2, 3, 4, 5, 6c, 7, 8d, 9c, 10c, and 11)			12	
Expenses	13 Program services (from line 44, column (B)) (see instructions)			13
	14 Management and general (from line 44, column (C)) (see instructions)			14
	15 Fundraising (from line 44, column (D)) (see instructions)			15
	16 Payments to affiliates (attach schedule—see instructions)			16
17 Total expenses (add lines 13 and 14, column (A))			17	
Net Assets	18 Excess or (deficit) for the year (subtract line 17 from line 12)			18
	19 Net assets or fund balances at beginning of year (from line 74, column (A))			19
	20 Other changes in net assets or fund balances (attach explanation)			20
	21 Net assets or fund balances at end of year (combine lines 18, 19, and 20)			21

For Paperwork Reduction Act Notice, see page 1 of the separate instructions.

Cat No 11282Y

Form **990** (1992)

ALIG - 2 1992

VERSION 3

Form **990****Return of Organization Exempt From Income Tax**

Under section 501(c) of the Internal Revenue Code (except black lung benefit trust or private foundation) or section 4947(a)(1) charitable trust

OMB No. 1545-0047

1993This Form is
Open to Public
InspectionDepartment of the Treasury
Internal Revenue Service

Note: The organization may have to use a copy of this return to satisfy state reporting requirements.

A For the calendar year 1992, or fiscal year beginning , 1992, and ending , 19

Please use IRS label or print or type. See Specific Instructions.	B Name of organization		C Employer identification number	
	Number and street (or P.O. box if mail is not delivered to street address)		Room/suite	D State registration number
	City, town, or post office, state, and ZIP code			
E If address changed, check box <input type="checkbox"/>				

F Check type of organization—Exempt under section ☐ 501(c)() (insert number),
OR ☐ section 4947(a)(1) charitable trust

H(e) Is this a group return filed for affiliates? ☐ Yes ☐ No(b) If "Yes," enter the number of affiliates for which this return is filed. ☐(c) Is this a separate return filed by an organization covered by a group ruling? ☐ Yes ☐ No

K Check here ☐ if the organization's gross receipts are normally not more than \$25,000. The organization need not file a return with the IRS, but if it received a Form 990 Package in the mail, it should file a return without financial data. Some states require a complete return.

Note: Form 990EZ may be used by organizations with gross receipts less than \$100,000 and total assets less than \$250,000 at end of year.

Part I Statement of Revenue, Expenses, and Changes in Net Assets or Fund Balances

1 Contributions, gifts, grants, and similar amounts received:		(A) Cash	(B) Noncash	
Revenue	a Direct public support	1a		
	b Indirect public support	1b		
	c Government grants	1c		
	d Total (combine line 1c, columns (A) and (B)) (attach schedule—see instructions)			1d
	2 Program service revenue (from Part VII, line 93)			2
	3 Membership dues and assessments (see instructions)			3
	4 Interest on savings and temporary cash investments			4
	5 Dividends and interest from securities			5
	6a Gross rents	6a		
	b Less: rental expenses	6b		
	c Net rental income or (loss)			6c
	7 Other investment income (describe)			7
Revenue	8a Gross amount from sale of assets other than inventory	(A) Securities	(B) Other	
		8a		
	b Less: cost or other basis and sales expenses	8b		
	c Gain or (loss) (attach schedule)	8c		
	d Net gain or (loss) (combine line 8c, columns (A) and (B))			8d
	9 Special fundraising events and activities (attach schedule—see instructions):			
	a Gross revenue (not including \$ of contributions reported on line 1a)	9a		
	b Less: direct expenses	9b		
	c Net income			9c
	10a Gross sales less returns and allowances	10a		
	b Less: cost of goods sold	10b		
	c Gross profit or (loss) (attach schedule)			10c
11 Other revenue (from Part VII, line 103)			11	
12 Total revenue (add lines 1d, 2, 3, 4, 5, 6c, 7, 8d, 9c, 10c, and 11)			12	
Expenses	13 Program services (from line 44, column (B)) (see instructions)			13
	14 Management and general (from line 44, column (C)) (see instructions)			14
	15 Fundraising (from line 44, column (D)) (see instructions)			15
	16 Payments to affiliates (attach schedule—see instructions)			16
	17 Total expenses (add lines 16 and 44, column (A))			17
Net Assets	18 Excess or (deficit) for the year (subtract line 17 from line 12)			18
	19 Net assets or fund balances at beginning of year (from line 74, column (A))			19
	20 Other changes in net assets or fund balances (attach explanation)			20
	21 Net assets or fund balances at end of year (combine lines 18, 19, and 20)			21

For Paperwork Reduction Act Notice, see page 1 of the separate instructions.

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Form **990** (1992)

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Page 2

Part II Statement of Functional Expenses

All organizations must complete column (A). Columns (B), (C), and (D) are required for section 501(c)(3) and (4) organizations and 4947(a)(1) charitable trusts but optional for others. (See instructions.)

Do not include amounts reported on line 6b, 8b, 9b, 10b, or 16 of Part I.		(A) Total	(B) Program services	(C) Management and general	(D) Fundraising
22	Grants and allocations (attach schedule). (cash \$ _____; noncash \$ _____)	22			
23	Specific assistance to individuals (attach schedule)	23			
24	Benefits paid to or for members (attach schedule)	24			
25	Compensation of officers, directors, etc.	25			
26	Other salaries and wages	26			
27	Pension plan contributions	27			
28	Other employee benefits	28			
29	Payroll taxes	29			
30	Professional fundraising fees (attach schedule)	30			
31	Accounting fees	31			
32	Legal fees	32			
33	Supplies	33			
34	Telephone	34			
35	Postage and shipping	35			
36	Occupancy	36			
37	Equipment rental and maintenance	37			
38	Printing and publications	38			
39	Travel	39			
40	Conferences, conventions, and meetings	40			
41	Interest	41			
42	Depreciation, depletion, etc. (attach schedule)	42			
43	Other expenses (itemize): a	43a			
b		43b			
c		43c			
d		43d			
e		43e			
f		43f			
44	Total functional expenses (add lines 22 through 43) Organizations completing columns (B)-(D), carry these totals to lines 13-15.	44			

Reporting of Joint Costs.—Did you report in column (B) (Program services) any joint costs from a combined educational campaign and fundraising solicitation? ☐ Yes ☐ No

If "Yes," enter (i) the aggregate amount of these joint costs \$ _____; (ii) the amount allocated to program services \$ _____; (iii) the amount allocated to management and general \$ _____; and (iv) the amount allocated to fundraising \$ _____.

Part III Statement of Program Service Accomplishments (See instructions.)

Describe what was achieved in carrying out the organization's exempt purposes. Fully describe the services provided; the number of persons benefited; or other relevant information for each program title. Section 501(c)(3) and (4) organizations and section 4947(a)(1) charitable trusts must also enter the amount of grants and allocations to others.

Expenses
(Required for 501(c)(3) and (4) organizations and 4947(a)(1) trusts; optional for others)

a (Grants and allocations \$ _____)	
b (Grants and allocations \$ _____)	
c (Grants and allocations \$ _____)	
d (Grants and allocations \$ _____)	
e	Other program services (attach schedule)	
f	Total (add lines a through e) (should equal line 44, column (B))	



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
U. S. House of Representatives
1135 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

This is in response to your letter of August 26, 1993, concerning the Subcommittee on Oversight's August 2, 1993, hearing to review the administration of, and compliance with, the Federal tax laws applicable to public charities. Because a number of the questions raised in your letter raise issues of tax policy, we have consulted with our colleagues in the Office of Tax Policy of the Department of the Treasury in preparing this letter. For your convenience we have provided each response immediately following a restatement of the question.

I. CASE STUDIES

- A. There were a number of cases where doctors received large loans as recruitment and retention tools (some without interest), bonuses, and salaries based upon the income taken in by their department of the hospital.
 1. Is it inurement when doctors get a bonus of hundreds of thousands of dollars from the hospital because they helped to develop a drug that was then licensed to a drug company?
 - A. The payment of a bonus to physicians in consideration of their efforts to develop a new drug is not necessarily inurement. First, inurement may result only when a charitable organization provides benefits to an "insider" who is in a position to exercise substantial influence over the organization's affairs. Thus, the bonuses could not be inurement unless the physicians were found to be insiders. Even if the physicians were insiders, the bonuses would constitute inurement only if they were unreasonable in amount.
 2. Why should hospitals be able to give interest-free loans to doctors?

- A. Under current law, there is no prohibition against making such loans as long as, under all the facts and circumstances, they do not result in prohibited inurement or other than incidental private benefit. Hospitals might properly give interest-free loans to physicians as part of an employee or independent contractor compensation package. A hospital might also make a loan to help a physician establish or expand a practice in an underserved area.
3. How are the hospitals reporting those loans on the Forms 990 and the Forms W-2, annual wage statements?
- A. Generally, [REDACTED]
- [REDACTED] We do not have any information, however, to support a suggestion that the practices in the few cases the Service has examined are representative of practices in the industry as a whole.
4. What other recruitment and retention incentives are being offered by hospitals that are of concern to the IRS, and what incentives or arrangements would be inurement?
- A. In addition to loans, we have identified such incentives as private practice income guarantees, cash bonuses, practice development or management subsidies, malpractice insurance subsidies, and free or reduced office rent. Our examination guidelines direct agents to examine these recruiting incentives carefully, as they may, depending on the facts and circumstances, represent prohibited inurement.
5. There are doctors receiving, as compensation, a percentage of the amount taken in by their department of the hospital. Is this arrangement common, and when is this inurement?
- A. [REDACTED] the Service approved a plan calling for payment to a hospital-based radiologist of a percentage of the adjusted gross revenues from the radiology department, in return for management and professional services, in Rev. Rul. 69-383, 1969-2 C.B. 113. In that ruling, the Service

looked for inurement in the relationship, but found that (1) the arrangement was negotiated at arm's length, (2) the physician had no control over, or management authority with respect to the hospital, and (3) the amount received did not represent excessive or unreasonable compensation for the services actually performed. The ruling cautioned, however, that the presence of a percentage compensation arrangement will destroy the organization's exemption if it transforms the principal activity of the organization into a joint venture between it and a group of physicians, if it is merely a device to distribute profits to persons in control, or if salaries or total compensation are not reasonable.

6. Has IRS ever revoked the tax-exempt status of a hospital? Under what circumstances would IRS revoke the tax-exempt status of a hospital?
 - A. During the past fifteen years, the Service has revoked the exempt status of one hospital: Anclote Psychiatric Center, Inc., of Tampa, Florida. In general, the Service would consider the use of a closing agreement to resolve compliance problems before taking a revocation action that might adversely affect the community served by the hospital.
7. If you find that a hospital's funds are inuring to the benefit of various insiders, through unreasonable compensation or otherwise, what would IRS do? Can IRS require that the individuals involved repay the money to the organization?
 - A. If an examination discloses that a hospital's funds are inuring to the benefit of insiders, the Service can propose to revoke the hospital's exempt status, or it can negotiate a closing agreement with the hospital that resolves the problem and allows the hospital to retain exempt status. Although the Service cannot require repayment, we can try to negotiate repayment as part of a closing agreement. After revocation, the Service notifies the appropriate attorney general, who may have authority under state law to take action to compel repayment. With respect to the individual insiders, the Service can conduct examinations to insure that all taxable benefits are included in income.

8. As part of a closing agreement, can IRS require that a charitable official resign?
- A. The Service cannot require an official to resign, though such a result could be negotiated.
- B. There was one case involving a public charity where the Executive and his family took more than \$150,000 in various benefits from the organization. The Executive had control of the entire operation with his family. The organization provided funds for college tuition for the Executive's child, the lease on a luxury car for the Executive's spouse, credit card bills for vacations and other expenses, kitchen remodeling at the Executive's home, and rental of a vacation house.
 1. Did the facts in this case evidence inurement?
 - A. The facts strongly suggested inurement had occurred, though no formal determination was made because the issues were resolved by agreement, as discussed below.
 2. Is the IRS considering revocation of the tax-exempt status of the organization?
 - A. This case was resolved by agreement that allowed the organization, [REDACTED] to retain exempt status. As part of the agreement, the organization's board was expanded and made more diverse, the executive was removed from the board, and better internal controls were instituted. Further, [REDACTED]

In addition, [REDACTED]
3. What showed up on the Form 990 in terms of compensation of these individuals?

- A. The organization's Form 990 showed only salaries. The personal expenses in issue were not shown as part of the compensation.
- 4. How were the amounts for the kitchen and the tuition reflected on the Form 990? How should they have been reported?
- A. The personal expenses were not readily apparent on the Form 990, as they were included with other organization expenses. They should have been reported as part of the executive's compensation.
- 5. Should an independent Board of Directors be required for all public charities?
- A. A charitable organization that has an independent governing board may be more likely to use its resources exclusively for charitable purposes than an organization that does not have an independent board. Nonetheless, requiring an independent board as a condition of exemption may be unduly rigid. For example, organizations in small communities might have difficulty attracting sufficient qualified and disinterested individuals to comprise an independent board. Therefore, rules that encourage an independent governing board may be preferable to rules that require such a board.
- C. There is a [REDACTED] which has provided its President with an interest-free loan of approximately \$100,000, free-housing, a second-home mortgage, limousine, and maid service. Further, [REDACTED] were provided mortgages at fair-market value.
 - 1. Is this inurement?
 - 2. Has [REDACTED] been cooperative with the IRS?
 - A. Because these questions relate to an open examination, we do not believe it would be appropriate for us to answer them.
 - 3. How was the interest-free loan, the mortgage on the President's home, and the limousine service shown on the Form 990?

- A. These items were not separately reported on the Form 990, nor were they included in the reported compensation paid to the President.
4. What should have been reported by [REDACTED] on the Form W-2, annual wage statement, for the President that was not reported?
- A. Because this question concerns issues pending in an open examination, we do not believe it would be appropriate for us to answer this question.
5. When a prominent tax-exempt university or hospital is involved in an IRS audit, will IRS ever conclude that there is inurement when the only sanction is revocation?
- A. We do not believe we should speculate as to what the Service would "ever" do, but we can say that the harshness of revocation makes it less likely that it would be imposed in any but the most egregious cases. As Commissioner Richardson testified before the Subcommittee on June 15, 1993, the lack of a sanction short of revocation of exemption in cases in which an organization violates the inurement standard causes the Service significant enforcement difficulties. Revoking the university's exemption may be an inappropriate penalty in an inurement case, as it could adversely affect the entire university community, without obtaining return to the university of the benefits that were inappropriately received from the university.
6. Has IRS ever revoked a university's tax-exempt status?
- A. During the past fifteen years the IRS has revoked the exemption of four universities: Bob Jones University, Magna Carta University, Clayton University, and John Marshall Law School. [REDACTED]
- D. There is an organization that spent funds for its CEO's wedding reception and tropical honeymoon (more than \$200,000), a trip to a health spa, and \$90,000 down payment on a home. None of these were reported as income on his individual tax return or included by the organization as compensation on the Form 990.

1. What did IRS do in this case?
 - A. Because this question concerns issues pending in an open examination, we do not believe it would be appropriate for us to answer this question.
2. How should a wedding reception payment and honeymoon be shown on the Form 990?
 - A. Payments by an organization of personal expenses of its CEO should generally be reported on Form 990 (and on Form W-2) as compensation paid to the CEO. On the Form 990, these amounts would be reported on line 25 of Part II (Compensation of officers, directors, etc.) and in column (C) of Part V (Compensation).
3. Are there other cases where a charity has spent charitable assets on personal expenses like a wedding, honeymoon, or visit to a health spa? Would these expenditures ever be justifiable?
 - A. There have been cases in which a charitable organization has paid personal expenses of high ranking employees. We are unable to provide precise data regarding the types of expenses involved in these cases, the frequency of their occurrence, or whether the expenses in issue were of the type mentioned. The payment by a charitable organization of personal expenses of an employee may be justified as reasonable compensation for the employee's services.
4. Should there be some tax applicable to non-exempt expenditures like these?
 - A. We, along with our colleagues in the Treasury Department, are working with the Subcommittee staff to consider the appropriateness of new sanctions on misuses of resources by charitable organizations. A tax on certain types of inappropriate expenditures is among the possibilities being considered.
5. If the above circumstances involved the officers of a large hospital or university governed by an independent Board, would the IRS revoke the tax-exempt status?
 - A. If the Service found clearly established private inurement in an examination of an organization, we would have little choice but to revoke exempt status or attempt to enter a closing agreement that would end the

inurement and impose some sort of sanction on the organization. However, we should note that the presence of an independent and active Board could be a factor in the determination whether the payments or other benefits constituted inurement.

- E. A religious organization was involved in a scheme involving in-kind contributions whereby [REDACTED] (for which the date of sale had expired) had been received by the ministry as a contribution. However, the supplies were outdated and therefore commercially worthless and the transactions were merely paper transactions. The supplies would be overvalued by a broker who would take a percentage of the amount involved and these same supplies may change hands (on paper) numerous times. The broker at the end would move the supplies to organizations overseas, which in some cases, could not even use the supplies provided. There were dozens of intervening exempt organizations in a single supply transaction. In one case, the IRS found the supply transaction resulted in an overstatement of contributions and expenditures of tens of millions of dollars.

1. Describe how the transactions were shown on the Form 990.

A. [REDACTED]

2. How were the dozens of intervening tax-exempt organizations involved?
3. Did the initial contributors of the supplies take a tax deduction for the contribution?
- A. Because Questions 2 and 3 concern issues pending in an open examination, we do not believe it is appropriate for us to answer these questions.
4. How can in-kind contributions generated by a tax-exempt organization be used to mislead donors?
- A. An organization may mislead donors by overvaluing in-kind contributions. By overstating the value of in-kind contributions, an organization can report on its

Form 990 greater public support than it actually receives. Moreover, if it, in turn, transfers the property in question to another charitable organization, the overvaluation of the property will result in an overstatement of the transferor's charitable program expenses. Transfer of property of an in-kind contribution through a number of charitable organizations can allow each organization to overstate both public contributions and charitable program expenses, all as a result of churning and overvaluing the same property. Finally, overstatement of charitable program expenses would make a given level of administrative expenses appear relatively lower. Thus, the organization's Form 990 could suggest that the organization is more efficient than is actually the case.

5. Are there certain in-kind contributions that should never be allowed, such as out-dated or worthless medical equipment?
- A. The principal tax issues raised by in-kind contributions relate to the deductibility of the contributions and the manner in which they are reported by the recipient. Under current law, the age of contributed property is a relevant factor in determining its value, and thus the deduction to which the contributor is entitled. See, e.g., Rev. Rul. 85-8, 1985-1 C.B. 59 (contributed pharmaceuticals valued at half their normal value because of proximity of expiration date).
6. How can the Form 990 be changed to better track the incoming and out-going contributions of goods?
- A. Current reporting requirements. -- Section 6033 of the Code and the regulations under that section do not require a Form 990 filer to differentiate between cash and noncash contributions received or paid. The Form 990 instructions do, however. "Contributions of \$5,000 or more (cash or noncash) generally must be listed on an attachment to the return. In the case of section 170(b)(1)(A)(vi) organizations, contributors of \$5,000 or more must be listed only if their contributions for the year are more than 2 percent of the total contributions received by the Form 990 filer in that year (Regs. 1.6033-2(a)(2)(iii)). The Form 990 instructions for this schedule of contributors state, "If the contribution consists of property whose fair

market value can be determined readily (such as market quotations for securities), describe the property and list its fair market value. Otherwise, estimate the property's value." The Form 990 instructions for line 22, Grants and allocations, require an attached schedule listing all grants made regardless of amount. The instructions for this schedule require a listing of each donee's name, address, amount given, as well as other information. These instructions also state, "If property other than cash is given and its fair market value when the organization gave it is the measure of the award or grant, also show on the schedule: (a) a description of the property; (b) its book value; (c) how the book value was determined; (d) how the fair market value was determined; and (e) the date of the gift. Record any difference between fair market value and book value in the organization's books of account and on line 20."

Possible reporting changes. -- The schedule of contributors discussed above and contributor information required by Part IV of Schedule A (Form 990) are the only parts of the form not open to public inspection. Thus, the public cannot ascertain the proportion of cash and noncash contributions received by an organization. The draft Form 990 that the Service supplied to the Subcommittee on August 2, 1993, would supply this information by requiring a dollar total of the cash contributions received and a separate dollar total of the noncash contributions received. These amounts would be reported on page 1 of the form itself and would thus be available to the public. A similar change would be made to line 22 to disclose separate totals for cash and noncash grants made. The instructions for line 22 would be revised to require information about all noncash grants made, whether measured by book value or fair market value. This information would be available to the public along with the currently required information regarding cash and noncash grants made.

7. What other types of property have been involved in cases involving in-kind contributions?
- A. We do not maintain formal records of these items, but as Marcus Owens, Director, Exempt Organizations Technical Division, testified before the Subcommittee on August 2, 1993, the types of property we have seen in cases involving in-kind contributions have included

agricultural products, including expired seeds; medical equipment and supplies; books, many times inappropriate for the asserted use; outdated pharmaceutical products; food supplies; and used clothes that should have been valued at salvage value by weight, but were overvalued at an assumed retail value.

F. There was a religious organization that paid an individual to put its name on a building overseas to create the appearance of an overseas "mission." At the same time, the building had the name of another religious organization on the other side. IRS believes that all money sent to the "mission" actually went into the pocket of one individual.

1. Donors contributing to this organization would believe that funds were going toward the overseas mission, showing the ministry's name on the side. Are there other similar cases under review?

A.



2. Should the Form 990 be revised to provide donors with information on amounts paid to specific overseas missions?

A. The Form 990 provides charitable organizations with flexibility in reporting their program expenses. This flexibility is appropriate because of the wide variety of programs conducted by these organizations. The utility of requiring a separate statement of amounts paid for any particular type of project may be questioned. It is difficult to know in advance which types of projects may be used in connection with questionable fundraising practices.

G. The minister of a religious organization benefitted when the organization paid a \$120,000 debt for him, picked up the mortgage on his home (although not authorized by the Board), paid for a house outside the U.S. for his father, and paid \$40,000 in golf club dues. None of this was shown on the minister's tax return.

1. Can a tax-exempt organization pay each of these expenses? If so, what should have been reported on the Form 990 and on the minister's individual tax return? If not, what is the sanction? What is IRS going to do in this case?

- A. In general, expenses of this nature may be included in a compensation package. However, we don't believe it would be appropriate to speculate on the consequences of any specific arrangement that may be at issue in a pending examination.
2. In this case, the minister maintained more than one parsonage. What are the consequences when IRS determines only one is allowable?
- A. Service position, based on use of the singular "home" in section 1.107-1 of the Income Tax Regulations, is that only one parsonage would be excludable from income under section 107 of the Code. The value of the second parsonage, or the amount of the second parsonage allowance, would be includable in the minister's gross income under section 61 of the Code.
3. This minister maintained a non-qualified pension plan. Describe the extent to which there is a problem with highly-compensated executives of tax-exempt organizations setting up non-qualified pension plans and avoiding taxes.
- A. We believe that there is broad use of non-qualified arrangements by tax-exempt organizations to provide benefits for executives, but we have no data suggesting problems. We should note that section 457 of the Code imposes limits on the amounts that can be deferred without being subject to tax in the year deferred.
4. Are there tax-exempt organizations shifting funds outside the U.S. to prevent IRS from monitoring these funds and collecting tax delinquencies?
- A. Although such a shifting, which can make it difficult for the Service to track the ultimate use of funds to determine whether they are being used to provide private benefits to insiders, may be occurring in a few cases, we have no knowledge or data that it is occurring on any broad scale.
4. There is a health care organization which purchased the private medical practices of doctors. The charity assumed all of the doctors' liabilities, employed all of the doctors' workers, took over the doctors' leases, and bought the doctors' medical equipment.
- [REDACTED]

[REDACTED] The CEO of the organization had personal expenses paid by the organization in excess of [REDACTED] for lunches, liquor, country club charges, tennis tournament tickets, airline tickets, and department store charges.

1. Were the payments of the CEO's personal items, such as country club and department store charges, shown on the Form 990?
- A. The only specific information with regard to salary reported on the Form 990 was the CEO's base salary.
2. How should the various expenses paid by an organization be reported on the Form 990? Could this disclosure be improved?
- A. The expenses described would represent ordinary compensation reportable in column (C) of Part V and as officers' compensation on line 25 of Part II. As the expenses appear to be personal expenses of the CEO, they would not be reportable in column (E) of Part V as fringe benefits or expense account allowances for which the CEO did not account to the employer. We believe the current Form 990 and instructions are adequate for disclosure with respect to officers' compensation.
3. Why would a tax-exempt organization pay four times the value to purchase doctors' medical practices? Were there kickbacks?
- A. Because this question relates to an issue involved in a pending examination, we don't believe it would be appropriate for us to respond to this question.
4. If the doctors were overpaid for their practices by a tax-exempt organization, can those funds be recouped and returned to the organization?
- A. The Service cannot require that funds be repaid to an organization. Depending on the circumstances, however, it might be possible to negotiate repayment as part of a closing agreement. If the Service were to revoke the exemption of the organization involved, it would notify the appropriate state attorney general. The attorney general might have authority to compel repayment.

5. Why would an organization operating the private practices of doctors be exempt? What is the charitable purpose?

A. An organization that operates the private practices of doctors would not necessarily qualify for tax-exemption. The organization's qualification as a charitable organization would depend on all of the facts and circumstances. If such an organization were to qualify, its charitable purpose would be the promotion of health. Under common law and the law of trusts, the promotion of health is a separate charitable purpose.

I. Some charities have paid up to 95 percent of the proceeds from their fund-raising effort to the professional fund-raiser. In some cases, the charities actually owe money to the fund-raiser at the end of the fund-raising contract and have nothing more to show for the huge fees than a mailing list which has been made worthless by the fund-raiser's sale and use of the list.

1. In cases reviewed by IRS, what has the Form 990 shown as amounts paid to professional fund-raisers?

A. As Marcus Owens, Director, Exempt Organizations Technical Division, testified before the Subcommittee on August 2, 1993, the true cost of fund-raising efforts is not readily discernable from the Form 990 because a substantial portion of the costs are generally allocated to and reported as program services rather than fund-raising costs on the premise that the solicitation letters serve the dual purpose of fund-raising and education.

2. How would donors learn about the total amount paid to a professional fund-raiser by a charity in looking at the organization's Form 990? Should the Form 990 better reflect this information?

A. Even when correctly completed, Form 990 often does not disclose all payments to a fundraiser. Part II of the form requires section 501(c)(3) and 501(c)(4) organizations to report their fund-raising expenses in column (D). Professional fund-raising fees are reportable in full on line 30 of column (D). Line 30 does not permit any allocation of these fees to program services (column (B)) or management and general (column (C)).

An organization may pay other amounts to a fundraiser that are not part of the fee and, therefore, are not reportable on line 30. These amounts include payments or reimbursements for printing, paper, envelopes, list rentals, postage, mailing services, purchases of items (such as greeting cards or address labels) mailed with a solicitation, processing of contributions received, updating of donor lists, and other costs reportable on various lines of Part II. All these expenses are reportable in column (D) with any other fund-raising expenses incurred by the Form 990 filer that do not involve an outside fundraiser. This combination of in-house and outside fund-raising expenses and the allocation of some joint costs to program services or management and general may make it impossible to determine the total amount of payments to a professional fund-raiser for fees and reimbursed expenses.

Form 990 or Schedule A (Form 990) could be expanded to require more detailed information about professional fund-raising. However, we believe it is more efficient for the Service and less burdensome to charities for the Service to work with the states to obtain this information. Most of the approximately 35 states with annual reporting requirements for charities require that each solicitation campaign involving an outside fundraiser be itemized. The charity must show the gross proceeds from a solicitation campaign, payments made to the professional fund-raiser, any other expenses paid, and the net proceeds to the charity. The Service is encouraging these states to adopt a uniform schedule for these expenses. A uniform schedule could be attached to the Form 990, eliminating the need to add to Form 990 or Schedule A (Form 990).

3. What types of fund-raising contracts result in a public charity owing funds to the fund-raiser and/or a worthless mailing list?
 - A. The contracts that can result in a charity owing funds to a fund-raiser are those in which the charity is responsible for a minimum expense payment, and thus bears the risk that the funds raised will not meet the costs of raising them. With respect to mailing lists, we believe the relevant inquiry is not whether or when it becomes worthless, but rather who has control and the right to exploit the list during its useful economic life.

4. What fund-raising contracts cause IRS concern and what action can IRS take in cases of abusive contracts?
- A. Fund-raising contracts that raise Service concern are those where expenses are so high that the organization is unable to carry on a charitable program commensurate with the funds raised. In such a case, the Service can revoke that charitable organization's exempt status. One example of this approach is P.L.L. Scholarship Fund v. Commissioner, 82 T.C. 196 (1984), which concerned an organization that was formed to raise funds for college scholarships by operating bingo games, but which in fact turned no money over to charity and was found to operate to benefit the private interests of the bingo operators who controlled the organization.
5. If a contract is simply a bad business decision, in what ways would the board of directors be accountable for the decision?
- A. State authorities may have authority to penalize trustees or managers for breaches of fiduciary responsibility.
6. When does a fund-raising contract represent inurement or private benefit?
- A. A fund-raising contract represents inurement when it results in excessive compensation to a "private shareholder or individual," defined in section 1.501(a)-1(c) of the Income Tax Regulations as "persons having a personal and private interest in the activities of the organization." The related concept of private benefit, which is set forth in section 1.501(c)(3)-1(d)(1)(ii), is broader, in that it requires an organization to be organized and operated for a public purpose rather than "private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests."

I. TAX NON-COMPLIANCE BY INDIVIDUALS EMPLOYED BY TAX-EXEMPT ORGANIZATIONS

- A. In 1991, the IRS conducted an examination of a physician which showed a substantial amount of unreported income due to the forgiveness of debt owed to the hospital which employed him. In total, the taxpayer agreed to pay \$150,000

in additional taxes, interest and penalties. IRS undertook a pilot project of Pittsburgh hospitals to determine whether this is an area of extensive noncompliance.

1. How many doctors did IRS look at in its pilot project to study individual tax compliance by doctors? What were the findings of the pilot project?
- A. The project was conducted in two phases. During the first phase, agents contacted 17 rural and smaller city hospitals and requested copies of their recruiting or employment agreements with medical professionals recruited since January 1, 1986. The agents reviewed 165 recruiting or employment agreements and selected 34 individual taxpayers for examination. In the second phase, the agents selected five urban hospitals and health care systems, reviewed 280 recruiting or employment agreements, and selected seven individual taxpayers for examination.

Results for the first phase have been mixed. Many physicians properly reported any incentives they received. Out of 34 taxpayers (representing 46 tax years or returns examined), 29 (representing 38 returns) have had their examinations closed. Eight taxpayers had adjustments to a total of 17 returns, though two (two returns) were minor adjustments unrelated to the scope of the project. Thus, six of the taxpayers (15 of 38 returns closed) experienced significant adjustments due to their receipt of recruiting incentives. The total amount of tax and penalties asserted in phase 1 to date is \$79,625, and the largest amount asserted against any one taxpayer was approximately \$46,000. Thirteen taxpayers (13 returns) had no changes asserted.

Based on preliminary information, the level of compliance determined in the second phase appears to be higher. The large, urban hospitals did not offer financial recruiting incentives as frequently as their rural or smaller-city counterparts. The physicians appear to have treated correctly those incentives that the urban hospitals did provide.

2. What types of transactions with the hospital were not reported by the doctors on their individual tax returns?

A. The significant adjustments made to six taxpayers (representing 15 of the 38 returns closed) in phase 1 due to receipt of recruiting incentives were mostly due to unreported income subsidies or debt forgiveness.

3. Of the one-third that owed additional taxes in the IRS study, there were two doctors who had not filed tax returns. What years were involved and why hadn't IRS detected the nonfiling?

A. Two doctors whose tax years were involved in the study had not filed returns, but both had been identified by other Service compliance initiatives. In the first case, the years at issue were 1986-1990, and the Service already had identified the failure to file for 1988 and was pursuing collection. The second case is still open, but, when we cross-checked, we found that the taxpayer had been identified under the high income nonfiler initiative.

4. Are loan arrangements involving the forgiveness of debt more prevalent in rural than in urban areas?

A. We lack the data to answer this question with certainty. Based solely on the Pittsburgh pilot project and opinions expressed in professional literature, it appears that loan arrangements involving forgiveness of debt probably are more prevalent in rural and in competitive urban areas than in urban and suburban areas generally.

B. The IRS National Office has received the findings of the Pittsburgh Pilot Project. Also, the Richmond IRS office has begun to look at this issue and is reviewing employment contracts.

1. How significant are the findings of the Pittsburgh project?

A. As we discussed above and in Exhibit E attached to our August 2, 1993, written testimony, the results of the first phase of the Pittsburgh Pilot Project have been mixed. Although significant adjustments were required to the returns of six taxpayers, many physicians properly reported any incentives they received.

2. What are the findings of the Richmond office thus far?

- A. The Richmond District's project is still in the very early stages.
- 3. What will be done to improve compliance and/or identify noncompliance?
- A. To identify noncompliance, additional IRS districts may replicate the Pittsburgh project once final results are known. We believe the high profile of the pilot project among accounting and legal professionals in the health care field may already have had a salutary effect on hospital reporting of financial incentives provided to physicians, especially regarding loan forgiveness, and on physician understanding of their income reporting responsibilities.

III. FORM 990

- A. The Subcommittee has found that there are sham transactions involving in-kind contributions. For example, organizations are receiving as contributions outdated medicine and overvalued books.
- 1. How are in-kind contributions shown on the Form 990 -- in terms of amount and in what manner?
- A. Our response to question E.6 of Part I gives detailed information about the current reporting requirement for noncash contributions received. To summarize, noncash contributions are reported at fair market value along with cash contributions on lines 1a through 1d of Part I of Form 990. The nondisclosable list of contributors of \$5,000 or more must include specific information about most noncash contributions received. The instructions requiring this list will be revised for 1993 to require information about all noncash contributions of \$5,000 or more.
- 2. How and in what amount would the Form 990 show in-kind contributions that are given by one charity to another charity or the needy?
- A. Noncash grants to other charities would be reported at fair market value on line 22, Grants and allocations, in Part II of Form 990. The instructions for line 22 require a listing of all donees and the amounts they received from the Form 990 filer. For noncash grants, the instructions require a description of the property, its fair market value, and information about how its

fair market value was determined. The schedule is open to public inspection.

Noncash contributions that were distributed directly to the needy by the reporting organization would be reported at fair market value on line 23, specific assistance to individuals. The instructions for line 23 state, in part, "Attach a schedule showing the total payments for each particular class of activity, such as food, shelter, and clothing for indigents or disaster victims; medical, dental, and hospital fees and charges; and direct cash assistance to indigents." This schedule is also available to the public.

3. Should the Form 990 have a separate line reflecting in-kind contributions received and donated?

A. As mentioned in our response to question E.6, our August 2, 1993 submission to the Subcommittee included a draft of a revised Form 990 that would require separate totals for cash and noncash contributions received on page 1 of Form 990. The draft form included a similar change for line 22, Grants and allocations. We believe these changes should be made and would welcome the Subcommittee's endorsement of our proposal.

B. Professional fund-raising costs have been identified as an area where donors cannot use the Form 990 to determine the full amount of a charity's income that remains in the hands of the professional fund-raiser.

1. We are aware of cases where fund-raisers retained 90 percent or more of the total amount raised. Where on the Form 990 would the public look to measure what percentage of the amounts raised actually went to the charity?

A. This information could be gleaned from the current form only if all contributions received were generated by one fund-raiser and all fund-raising costs were attributable to the fund-raiser and were correctly reported in column (D), Fund-raising, of Part II. Information about the percentage of solicited funds going to a fund-raiser would be diluted if the organization received other contributions or bequests not generated by the fund-raiser.

2. How can the Form be revised to have the full amounts paid to certain professional fund-raisers identified, especially where there is one fund-raiser involved?
- A. The simplest change would be to adopt a schedule that is already required by a number of states, including New York. New York's supplemental state form provides precise information about net fund-raising proceeds in Schedule 2, Professional Fund-Raisers (PFR). This schedule has four columns for different fund-raising drives or events and the following line item captions:
 1. Brief description of campaign, drive or event
 2. Date or period covered
 3. PFR name and address
 4. Total public donations*
 5. All payments to PFR
 6. All other fund-raising expenses for each event
 7. Total expenses (line 5 plus line 6)
 8. Net proceeds (line 4 minus line 7)

* On line 4, DO NOT exclude amounts retained by Professional fund raiser (e.g., amounts reported on line 5).

- C. The Form 990 does not separately itemize or report fringe benefits such as limousines, maid service, and housing.
 1. Should fringe benefits be separately reported to ensure that the public and IRS can fully monitor these payments?
- A. Part V of Form 990 and Part I of Schedule A (Form 990) together require a listing of the names of all officers, directors, trustees and key employees (whether or not compensated) and of the five highest paid employees paid more than \$30,000. These schedules and accompanying instructions require that all forms of compensation be reported, whether paid currently or deferred, cash or noncash, taxable or nontaxable. Column (e) of both parts is titled "Expense account and other allowances." The instructions require the reporting of all fringe benefits even if nontaxable. The only change to these instructions that we were considering for 1993 was to exclude de minimis fringe benefits described in section 132(e).

2. What is IRS doing to ensure that tax-exempt organizations properly report these amounts on the W-2 annual wage statement or other information returns?
 - A. Internal Revenue Manual 7(10)69, Exempt Organizations Examination Guidelines Handbook, calls for exempt organization examiners to verify that employment tax returns and Forms W-2 were filed as required and that they were substantially correct. These guidelines provide specific instructions to determine whether various kinds of taxable fringe benefits are provided to employees and, if so, whether they are properly reflected on the Forms W-2 provided the employees receiving the benefits.
- D. Severance pay and bonuses are included in the amount reported together on the Form 990 as compensation and, therefore, it is difficult for donors to determine the reasons for the amount reported.
 1. Should the various forms of compensation be separately reported on the Form 990?
 - A. For officers, directors, trustees, key employees and the five highest paid employees over \$30,000, the Form 990 and Schedule A (Form 990) already provide for a three-way breakdown of these individuals' compensation package: compensation paid the employee; deferred compensation and contributions to employee benefit plans; and expense accounts, allowances, and fringe benefits. We do not believe that it would be worthwhile to add one or two columns (even if space were available) to report severance pay and bonuses separately or together. The instructions for Part V of the 990 and Part I of Schedule A alert filers that they may attach a statement to explain any compensation arrangement for any one or all of the persons listed in those parts. An attachment would be the proper place to explain that one or more salaries included severance pay or bonuses.
 2. How should a signing bonus be reported on the Form 990 -- the full amount in the first year or over the term of the contract?
 - A. A signing bonus paid to an employee in a particular year should be reported in full in Part V of Form 990 or Part I of Schedule A in the year of the payment. The organization can use an attachment (discussed

above) to explain that the salary figure includes a signing bonus paid in that year.

- E. Transactions between related parties and the charity are reported, in part, on the Form 990. There are some transactions that are not reported to IRS that are required by the State of Massachusetts which may assist donors in monitoring these insider transactions.
1. How could the definition of related parties or related-party transactions be expanded on the Form 990 to improve its utility?
 2. Should the definition of related party include children and spouses of charity officials?
 - A. The draft Schedule A (Form 990) that we provided the Subcommittee on August 2, 1993, reflected a possible change to question 2 of Part III regarding related party transactions. We proposed to expand the reporting requirement to include transactions with members of the family of officers, directors, trustees, creators, and key employees. We believe the definition of "members of the family" should be consistent with the definition in section 4946(d) of the Code.
 3. Should the reportable transactions be expanded to include: (a) loans from or interest waivers by related parties, or (b) investments in a related party?
 - A. Loans to and from related parties (officers, directors, trustees and organizations they own or control) are already required to be reported in Part III of Schedule A and on an attached schedule explaining the transaction or arrangement. A waiver of interest due from a charity to a related party would benefit the charity instead of the related party and thus would not constitute inurement. Nonetheless, such a waiver should be reported on the attachment.
- Requiring specific information on investments in a related party is worth considering if the term "related party" is limited to taxable entities in which officers, etc. own a substantial interest (in excess of either a 35 percent or 50 percent threshold).
4. How can the Form 990 be changed to improve the information available on transactions between a charity and its taxable and tax-exempt subsidiaries?

- A. Part VII of Schedule A (Form 990) already requires detailed information about transactions between charities and their tax-exempt subsidiaries that are not section 501(c)(3) organizations. No additional information is needed in that area. Transactions between a charity and its tax-exempt subsidiaries generally do not give rise to compliance concerns. Part V of Form 990 does require section 501(c)(3) organizations to report (on an attachment) the compensation paid to any of its officers, directors, trustees, or key employees by related organizations, whether exempt or taxable, if the related organizations together pay any one person more than \$10,000 and that person's aggregate compensation is more than \$100,000.

As to transactions with taxable subsidiaries, it might be worth considering expanding question 2 of Part III of Schedule A to include such transactions and requiring a detailed explanation.

- F. Under current law disclosure and reporting requirements, the Form 990 is public but other information related to IRS's action regarding these organizations is not public.

1. What types of IRS action should be reported on the Form 990 to allow for better disclosure of IRS activities involving a tax-exempt organization?

- A. The fact that an organization is currently recognized by the Service as a section 501(c)(3) organization, as evidenced by the organization's listing in Publication 78, may give many people the erroneous impression that the Service has recently reviewed (examined) the organization's activities and found them to be appropriate to retain exempt status. But the organization may not have been examined for a number of years or it may never have been examined. If there has been no recent examination, the organization may have significantly changed its activities, particularly if there has been a change in its officers or directors. If the organization has never been examined, the Service has never verified that the organization has engaged exclusively in the activities specified in its exemption application.

Disclosing the year of the most recent IRS examination would provide meaningful information to different segments of the public.

2. When tax-exemption is revoked what type of information should be made available to the public and how?
- A. When a final notice of revocation is sent to an organization, either after the organization exhausted its administrative appeal rights or after it has defaulted by not responding to the initial notice, the Service publishes a notice in the Internal Revenue Bulletin that the organization no longer qualifies as an organization eligible to receive deductible contributions under section 170(c)(2) of the Code.

If the revocation is upheld by a declaratory judgement court, the Service publishes another notice in the Internal Revenue Bulletin to establish the cutoff date for deductible contributions.

We, along with our colleagues in the Treasury Department, are working with the Subcommittee staff to consider possible means of improving compliance by public charities. Additional disclosure requirements are among the measures being considered.

IV. IRS ACTIVITIES

- A. In the 20 cases where IRS has revoked the tax-exemption due to inurement in 1991 and 1992, none have involved hospitals or universities. It appears that IRS is unwilling to determine there is inurement at these organizations because the only available sanction is revocation of tax-exemption.
 1. Where revocation has been due to unreasonable compensation, what types of compensation were involved and in what amounts?
- A. Among the 20 revocation cases in 1991-1992, three involved revocation on the basis of unreasonable compensation.

(1)



(2) [REDACTED] - The founder and CEO received "profits" from a venture before it was completed and before a determination of its profitability. The founder received [REDACTED] and the CEO received [REDACTED]. The venture resulted in a loss on the books of the organization. The two individuals subsequently returned the money to the organization.

(3) [REDACTED] - The founder and sole signatory on the organization's bank account paid additional amounts to [REDACTED] self in addition to [REDACTED] salary. In each year under examination, the non-salary amounts exceeded [REDACTED] purported salary:

1987	salary	[REDACTED]	nonsalary	[REDACTED]
1988	salary	[REDACTED]	nonsalary	[REDACTED]
1989	salary	[REDACTED]	nonsalary	[REDACTED]

The only explanation offered for the substantial salary and nonsalary increases was an increase in available funds.

2. If there was an intermediate sanction for inurement, would IRS be more likely to look for inurement and to find that certain salaries, bonuses, and benefits actually constitute inurement?
 - A. No. The Service currently looks for inurement. If we identify cases involving possible inurement, however, our enforcement options are limited. We can, of course, seek to revoke the organization's exemption. We may conclude, however, that, because of the good being accomplished by the organization, revocation of its exemption is an inappropriate sanction. In such cases, we may attempt to negotiate a closing agreement that would prohibit future transactions of the type that gave rise to concern. Closing agreements, however, are not an ideal enforcement tool. Because each agreement results from separate negotiations with a particular organization, it is difficult to ensure that similar organizations are treated consistently.
3. What are examples of expenditures by a charity that do not constitute a charitable or tax-exempt purpose -- but may not be construed as inurement? What is the sanction for these expenditures?
 - A. Examples of expenditures by a charity that do not constitute expenditures for charitable or tax-exempt

purposes, but may not be construed as inurement, usually fall within the ambit of unrelated expenses. If these expenditures are made to further a business that is regularly carried on, it is covered under the unrelated business income area. Another example is fund-raising. The actual soliciting of funds is not by itself charitable, but if the funds are ultimately used to further charitable purposes, this is permissible. On the other hand, if the fund-raising is used to perpetuate the business of fund-raising, this is a nonexempt activity. If the nonexempt activity is substantial in nature it would result in revocation of the organization's exempt status.

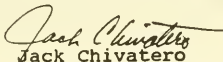
- B. For public charities, there are no established tax rules related to per se inurement. In the private foundation area, there are some activities that would represent per se self-dealing, such as the sale or leasing of property between the foundation and certain "disqualified" persons, and the lending of money between a private foundation and these persons.
 - 1. Are there some transactions between "insiders" and charities that should be prohibited as per se inurement? If so, what are they?
 - 2. Are there any firm guidelines for compensation that could be or should be established, such as no more than \$1 million a year?
 - 3. Are there transactions that IRS believes or considers should be taxable, such as excessive consulting or fund-raising fees?
- A. As noted, we, along with our colleagues in the Treasury Department, are working with the Subcommittee staff to consider possible means of improving compliance by public charities.
- C. The 1993 budget reconciliation bill includes a provision to limit the tax deduction allowed to publicly-held corporations for compensation paid with respect to certain employees to no more than \$1 million per year. In the past, IRS has looked at comparable corporation CEO salaries as a measure of whether tax-exempt organization salaries are reasonable.
 - 1. Will public charity salaries in excess of \$1 million now be considered unreasonable?

- A. Whether compensation is reasonable is a question determined by the facts and circumstances in each case. As section 1.162-7(b)(3) of the Income Tax Regulations provides, reasonable compensation is "only such amount as would ordinarily be paid for like services by like enterprises under like circumstances."
2. Should public charity salaries in excess of \$1 million be allowed?
- A. We are concerned that a fixed ceiling for salaries paid by a public charity may be unduly rigid. The reasonableness of compensation depends on many factors unique to each case. Therefore, it may be more appropriate to continue to determine the reasonableness of salaries on a case-by-case basis.
- D. Should IRS be authorized to issue certain tax-exemptions for a limited period of time, especially where there is concern about the charity's validity or a limited time frame for the charity's mission, such as natural disaster relief?
- A. We are concerned that any benefits from time-limited exemptions may not justify the additional paperwork it would require of both taxpayers and the Service. Concerns regarding the activities of an exempt organization after its initial grant of exemption can be addressed through the audit process.

We trust that this information is useful to you. If you have any questions or concerns about the information, please feel free to contact me.

Best regards.

Sincerely,



Jack Chivatero
Acting Assistant to the Commissioner
(Legislative Liaison)



COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

NOV 17 1993

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
1135 Longworth Building
Washington, DC 20515

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Ways and Means
Subcommittee on Oversight

Dear Mr. Chairman:

This letter transmits the publicly disclosable report on Internal Revenue Service actions concerning media evangelists for the period beginning April 1, 1993, and ending June 30, 1993. The report, which includes a fact sheet on each media evangelist, provides you with the level of detail you requested. I previously sent you the report containing information protected from public disclosure by IRC 6103.

The Service has continued its efforts to ensure compliance by media evangelists with the Internal Revenue Code. Service functions involved in these efforts include Employee Plans and Exempt Organizations, Examination, Collection, and Criminal Investigation. Each of our seven regions has at least one open media evangelist case.

Currently, there are a total of 18 media evangelists, as well as related entities and individuals, subject to various types of actions. These cases include income tax examinations, examinations concerning exempt status, collection procedures, church tax examinations and criminal actions. You should be aware that most information concerning particular evangelists that is gathered by the Service cannot be disclosed once the case is docketed in court. Thus, the disclosure rules prevent us from discussing several cases where the government has not completed action.

Best regards.

Sincerely,

Gayle G. Morin
Assistant to the Commissioner
(Legislative Liaison)

Enclosure

MEDIA EVANGELIST: X

Background Information:	Related Entities/Individuals:
<p>X holds himself out to be a minister, although the two exempt organizations of which he is the president do not claim church status. The two organizations are A and B. The organizations publicize X walking through poverty stricken countries soliciting contributions. Examinations of both organizations resulted from an examination of X. Both cases involve lack of charitable activity and excessive salaries to X.</p> <p>Issues:</p> <ul style="list-style-type: none"> o 1099 Reporting o Personal Income Tax 	<p>X is president of A and B. Neither organization claims church status.</p>

Status:**Period Ending 6/30/92**

1988-1991 tax years of A and B are under examination.

Period Ending 9/30/92

The examinations of A and B are continuing. After determining that X received additional compensation, EP/EO Division forwarded the information to Examination Division.

Period Ending 12/31/92

Based on the information uncovered by EP/EO Division showing that X received additional compensation, Examination Division has X's returns for open years under examination. The examinations of A and B have been completed. After a full review, EP/EO Division has determined that these organizations are operating consistent with the requirements of IRC 501(c)(3). The only area of non-compliance was found in the reporting requirement of compensation to independent contractors. Delinquent Forms 1099 have been secured and the pertinent information has been referred to Examination Division.

Period Ending 3/31/93

A 30-day letter was issued to X proposing income tax adjustments. Claimed deductions were disallowed and additional compensation was found. The case is now pending in Appeals.

Period Ending 6/30/93

The case concerning the income tax examination of X was returned from the Appeals Office for further development. Issues involve charitable contributions to controlled organizations, housing allowance, and loans received from a controlled organization.

MEDIA EVANGELIST: X1

Background Information:	Related Entities/Individuals:
<p>A review of A's annual information returns identified some areas of concern. X1, who claims to be a minister of the Gospel, founded and operates the organization, along with family members. The organization, which is exempt under IRC 501(c)(3), sponsors a religious program on cable television. The organization is under examination for tax years 1989-1990. Primary issues are: (1) unreasonable compensation to X1 and family members; (2) use of assets to serve the private benefit of X1 and family members; (3) liability for employment taxes, and; (4) acquisition of real property from X1 in excess of fair market value.</p> <p>Issues:</p> <ul style="list-style-type: none"> o Inurement o Private Interest o Employment Taxes 	<p>A, an IRC 501(c)(3) organization founded and operated by X1.</p>

Status:**Period Ending 12/31/92**

This is the first time we are reporting on this case. Forms 990 filed by A for tax years 1989 and 1990 are under examination.

Period Ending 3/31/93

Examination of A is continuing.

Period Ending 6/30/93

The examination of A continued. All issues are being developed.

MEDIA EVANGELIST: X3

Background Information:	Related Entities/Individuals:
<p>X3 has a weekly radio show in the Q area. X3 was reported to be diverting contributions from A, an organization he controls, to his personal use. Numerous business ventures are being conducted by A. As a result of an examination of X3's Forms 1040 for 1986 and 1987, a statutory notice of deficiency was issued and the examination was closed. A, which claims to be a church, is currently subject to an examination being conducted pursuant to the church examination procedures.</p> <p>Issues:</p> <ul style="list-style-type: none"> o Exempt Status o Unreported Income o Failure to File Tax Returns o Employment taxes 	<p>A, a related organization claiming church status (D/B/A A1). C, C1, C2, C3, C4, C5, C6, C7, C8, and C9 are taxable entities associated with X3.</p>

Status:**Period Ending 6/30/92**

A notice of examination was sent to A/A1.

Period Ending 9/30/92

A/A1 is under examination.

Period Ending 12/31/92

The examination of A/A1 is continuing.

Period Ending 3/31/93

The examination of A/A1 is continuing. Inurement is being considered as a possible issue, and a third party summons requesting financial records has been issued to a credit card company.

Period Ending 6/30/93

A proposed revocation letter to A based on inurement has been submitted to District Counsel for review.

MEDIA EVANGELIST: X5

Background Information:	Related Entities/Individuals:
<p>X5, a television evangelist, founded, controls and broadcasts over A, an exempt organization under IRC 501(c)(3). The organization was identified for examination under the EP/EO Coordinated Examination Program. Forms 990 filed by A for years 1990 and 1991 will be examined. The organization controls numerous related exempt organizations and taxable entities operating in the United States and overseas. Reports in the media have identified several potential issues. These include: (1) excessive compensation to the founder and his family members; (2) use of organization's assets to serve private interests of founder and family; (3) engaging in political activity by specifically supporting candidates for public office, and (4) treating employees as "ministers" to avoid employment tax liability.</p> <p>Issues:</p> <ul style="list-style-type: none"> o Inurement o Private Interest o Political Activity o Employment Taxes 	<p>A, an IRC 501(c)(3) organization controlled by X5.</p>

Status:

Period Ending 12/31/92

This is the first time we are reporting on this case. Contact by mail was made with A concerning the commencement of an examination under the EP/EO Coordinated Examination Program (CEP).

Period Ending 3/31/93

The organization has been requested to submit information for examination purposes.

Period Ending 6/30/93

The examination of A commenced. Information from A has been requested. The organization is claiming it does not control other entities.

MEDIA EVANGELIST: X8

Background Information:	Related Entities/Individuals:
<p>Examination Division is examining X8's income tax return for the 1990 tax year. X8 is the minister for A, an organization claiming church status. He is seen on television on weekdays and on Sundays in the Q area.</p> <p>Issues:</p> <ul style="list-style-type: none"> o Unreported Income o Deductions 	<p>A, an organization claiming church status.</p>

Status:**Period Ending 12/31/92**

This is the first time we are reporting on this case. Examination Division is currently examining X8's 1990 tax year.

Period Ending 3/31/93

Examination Division forwarded an information report to the EP/EO Division because of the probability of X8 commingling personal funds with the funds of A.

Period Ending 6/30/93

The examination of X8 is continuing. There is a possibility of unreported income and a questionable percentage of Schedule A contributions compared to income.

MEDIA EVANGELIST: X9

Background Information:	Related Entities/Individuals:
<p>Media reports allege X9 falsely claims to be donating substantial amounts to an overseas charity. The media reports also allege that X9 supports an extravagant life style by diverting for his personal use funds raised for charitable purposes.</p> <p>Issues:</p> <ul style="list-style-type: none"> o Exempt Status o Inurement o Unreported Income 	<p>A, information N/A.</p>

Status:**Period Ending 6/30/92**

Matters have been referred to Criminal Investigation Division for consideration.

Period Ending 9/30/92

No change in status.

Period Ending 12/31/92

No change in status.

Period Ending 3/31/93

No change in status.

Period Ending 6/30/93

No change is status.

MEDIA EVANGELIST: X11

Background Information: X11's organization, A, was selected for examination because of questions concerning valuations of in kind contributions. X11 solicits for funds on television. Forms 990 for years 1990 and 1991 are being examined. A pre-examination conference was held and a request for documents was made. The organization does not claim church status. Issues: o Inurement	Related Entities/Individuals: A, X11's missionary organization, does not claim church status.
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Status:**Period Ending 9/30/92**

This is the first time we are reporting on this case. Forms 990 of A for years 1990 and 1991 are under examination.

Period Ending 12/31/92

A meeting was held with Examination Division to discuss issues and resources related to a number of taxable subsidiaries. Records for A were requested.

Period Ending 3/31/93

The examination of A is continuing.

Period Ending 6/30/93

Notices of proposed adjustments were issued.

MEDIA EVANGELIST: X12

Background Information:	Related Entities/Individuals:
<p>Media reports have alleged that X12, who operates A, a television ministry, raises funds by falsely claiming to be supporting a church in S. In addition, the reports charged that X12 falsely or misleadingly claimed financial hardship. His appeals for funds emphasized the loss of substantial personal assets, but fail to reveal that he owns similar assets elsewhere. After consideration, Criminal Investigation Division returned the case to EP/EO Division.</p> <p>Issues:</p> <ul style="list-style-type: none"> o Exempt Status o Inurement o Unreported Income 	<p>A, an IRC 501(c)(3) organization.</p>

Status:**Period Ending 6/30/92**

The EP/EO Division is preparing to examine Form 990 filed by A for the 1990 tax year. Examinations of individuals and related businesses will be conducted as appropriate.

Period Ending 9/30/92

The examination of A has been postponed until the organization completes its 1991 return. The CPA for the organization is expected to continue his work in December 1992. The organization is having severe financial problems since it received adverse media publicity and is on the verge of bankruptcy. The EP/EO Division feels that it is advisable to allow the organization reasonable time to get its records in order.

Period Ending 12/31/92

EP/EO Division began reviewing the records of A. The initial examination work indicates the possibility of inurement due to personal usage of the organization's credit cards and certain real property transactions.

Period Ending 3/31/93

Forms 990 filed by A for years 1989-1991 are under examination.

Period Ending 6/30/93

Notices of proposed adjustment were issued to A. Issues included inurement, parsonage rental value, non-qualified annuities, employment taxes, and failure to file required returns.

MEDIA EVANGELIST: X13

Background Information:	Related Entities/Individuals:
<p>X13 is the media evangelist controlling A and B. Actions against these organizations for employment taxes are in process in Collection Division.</p> <p>Issues:</p> <ul style="list-style-type: none"> o Employment Taxes 	<p>A, B</p>

Status:**Period Ending 9/30/92**

This is the first time we are reporting on this media evangelist. Collection Division actions for employment taxes against A, and B are pending.

Period Ending 12/31/92

The cases are pending with Collection Division, which is obtaining financial information.

Period Ending 3/31/93

Financial statements of A and B show monthly expenses in excess of monthly income. The 100 percent penalty is being proposed.

Period Ending 6/30/93

The 100 percent penalty has been asserted against X13.

MEDIA EVANGELIST: X14

Background Information:	Related Entities/Individuals:
<p>In 1989, action against A was initiated because an information gathering project on TV ministers disclosed possible inurement of earnings to the organization's founder. Agents from both EP/EO and Examination Divisions have been involved. EP/EO examined returns of A for years 1986 through 1988. A request for technical advice is pending in the National Office concerning proposed revocation of exempt status in view of inurement of earnings, substantial expenditures for non-exempt purposes and significant commercial activities. Examination Division completed examinations of taxable entities and related individuals. Additional taxes were proposed and not agreed to. These cases were forwarded unagreed to Appeals.</p> <p>Issues</p> <ul style="list-style-type: none"> o Inurement o Unreported Income o UBIT 	<p>A, a related organization, claiming church status, founded by X14.</p> <p>The Cs, related individuals.</p> <p>The C1s, related individuals.</p> <p>The C2s, related individuals.</p> <p>The C3s, related individuals.</p> <p>D, a related taxable entity.</p> <p>D1, a related taxable entity.</p>

Status:

Period Ending 6/30/92

With respect to years 1989-1991, a Church Tax Examination Notice has been issued and a conference has been held with A. D1 has filed for bankruptcy. X14 recently became involved in litigation in his personal capacity.

Period Ending 9/30/92

A technical advice request is still pending in the National Office regarding proposed revocation of A for years 1986-1988. A conference was held with the organization concerning examination of years 1989-1991. The organization has failed to make its books and records available. A summons was served on the organization and the matter is under consideration by District Counsel.

Period Ending 12/31/92

The technical advice request proposing revocation of A for years 1986-1988 because of inurement of earnings and private benefit is still pending in the National Office. The Justice Department is attempting to expedite enforcement of the summons served on the organization requesting records needed in connection with the examination of years 1989-1991. Final results of cases against individuals related to X14 depend on the outcome of the proposed revocation of A. EP/EO Division has requested Examination Division to examine all non-exempt related

Period Ending 3/31/93

Based on technical advice, a proposed revocation letter to A and a statutory notice of deficiency for A for years 1986-1988 have been prepared and submitted to District Counsel for review. The Department of Justice is pursuing summons enforcement in connection with the examination of A for years 1989-1991, and A has consented to extend the statute for assessment of income tax for the tax year ended June 30, 1989. X14 has no assets. Related cases are in the Appeals Office.

Period Ending 6/30/93

A final revocation letter and a statutory notice of deficiency have been issued to A for years 1986-1988. Regarding years 1989-1991, a conference required under IRC 7611 procedures has been held with the organization, but an examination of books and records has not begun. The Department of Justice is pursuing summons enforcement.

MEDIA EVANGELIST: X15

Background Information:	Related Entities/Individuals:
<p>The examination of A for years 1985 through 1987 began in 1987 as the result of alleged political activities by A and other related organizations. That examination is being held open pending development of an examination of tax years 1988 through 1990 which should determine if the sale of A's assets to D resulted in private benefit to X15.</p> <p>Issues:</p> <ul style="list-style-type: none"> o Exempt status o Use of exempt organization's assets for personal gain 	<p>A, a related IRC 501(c)(3) organization. C, a related 501(c)(4) organization. D, a taxable entity.</p>

Status:

Period Ending 6/30/92

Examination activities are continuing. Consideration is being given to the effect of the sale of A's assets to D. An engineer and an economist are helping the district evaluate information A has provided. The examination continues to consider the issue of political activity as it relates to A and the C, as well as an allocation of expenses problem between the 990 and 990-T returns of A.

Period Ending 9/30/92

A proposed request for technical advice has been submitted to the taxpayer for comment before it is sent to the National Office.

Period Ending 12/31/92

A request for technical advice has been submitted to the National Office.

Period Ending 3/31/93

The request for technical advise is pending in the National Office.

Period Ending 6/30/93

A conference was held in the National Office on the technical advice request with representatives of A.

MEDIA EVANGELIST: X16

Background Information:	Related Entities/Individuals:
<p>X16 claims to be a minister. Through his organization, A, which claims church status, he uses television extensively to appeal for contributions to fight starvation. Questions exist as to whether these contributions are inuring to the benefit of X16 and whether contributions in kind are being overvalued. The organization is currently under examination for years 1987 through 1989. Examination activity will be broadened to include related individual and business returns as may be appropriate. B, is under examination for tax years 1989-1990. It does not claim church status.</p> <p>Issues:</p> <ul style="list-style-type: none"> o Inurement o Exempt Status 	<p>A, a related organization that claims church status. B, a related 501(c)(3) organization.</p>

Status:**Period Ending 6/30/92**

The examination of A is continuing.

Period Ending 9/30/92

Examinations of the books and records of A and B are continuing.

Period Ending 12/31/92

A signed a suspension of the two year church examination period. Interviews were held with principal staff members. Notices of Proposed Adjustment were issued dealing with unrelated business income, employment taxes, foundation status and gifts in kind. Regional Counsel reviewed the Notices of Proposed Adjustment issued to date and discussed how the issues of inurement, operations and foundation status should be addressed in the final Revenue Agent's Report. Examination work on B continued. Notices of Proposed Adjustment have been issued for unrelated business income and employment taxes. Examination Division is examining tax returns filed by X16 and his spouse for years 1988-1991.

Period Ending 3/31/93

Technical advice requests are being prepared in the cases of A and B.

Period Ending 6/30/93

It was decided that technical advice, which we previously reported as being prepared, was not needed. A proposed examination report to A is being reviewed by Regional Counsel. Issues relate to unrelated business income tax, employment taxes, and revocation of IRC 501(c)(3) status due to inurement and non-exempt purposes. Proposed adjustments concerning B relate to unrelated business income, employment taxes, and the method of valuation for gifts-in-kind.

MEDIA EVANGELIST: X17

Background Information:	Related Entities/Individuals:
<p>Media reports have alleged that X17 raises large sums of money through fraudulent or misleading claims. The reports also pointed out that although X17 implies that funds are being solicited for special needs, he is careful to avoid asking for money for a specific purpose. Furthermore, the reports alleged that only a small part of fundraising proceeds are used for charitable purposes. Finally, the reports suggested that X17 has connections to criminal activity. A church tax examination notice was sent to A for the 1991 tax year. Related individual and business returns will be examined as may be appropriate.</p> <p>Issues:</p> <ul style="list-style-type: none"> o Exempt Status o Inurement o Unreported Income 	<p>A, a related organization claiming church status. B, spouse of X17. C, a former officer and employee of A. D, a bank associated with A. E, vendor of A. F, vendor of A. G, attorneys and financial advisors of A.</p>

Status:**Period Ending 6/30/92**

Arrangements are being made for the examination of A for the 1991 tax year.

Period Ending 9/30/92

In connection with the examination of A, the Service has made a request for documents which has been partially complied with.

Period Ending 12/31/92

Actual review of records requested is scheduled to begin in early January 1993.

Period Ending 3/31/93

EP/EO Division is continuing to examine A for years 1989-1991. Forms 1040 for years 1990-1991 filed by X17 and B are under examination. Forms 1040 for years 1989-1990, filed by C are being examined. Forms 1120 of D, E, and F are being examined. Forms 1065 filed by G are under examination.

Period Ending 6/30/93

Examinations are continuing. An examination of C was concluded. No significant issues were found. An examination of G has not begun.

MEDIA EVANGELIST: X18

Background Information:	Related Entities/Individuals:
<p>An individual examination was begun in 1985 because of X18's failure to file Forms 1040. This led to assessments against related organizations for failure to pay employment taxes and 100% penalty against X18. As a result of the individual examination, X18 has filed returns for 1989 and 1990, paid individual income tax owed and is in full compliance with individual filing and payment requirements.</p> <p>Issues:</p> <ul style="list-style-type: none"> o Unreported Income o Civil Penalties o Criminal Liability o Employment Taxes 	<p>A, a related 501(c)(3) organization. B, a related organization that claims church status.</p>

Status:**Period Ending 6/30/92**

Assessments for employment taxes through December 1, 1991, for both A, and B have been made against X18. Levies have been served on X18's wages and bank account. The levy on wages is not being honored. Because the Service wants to ask the court to enjoin A and B from pyramiding unpaid employment taxes, a suit to enforce the levy will not be recommended at this time.

Period Ending 9/30/92

A small amount was received from X18's bank account. The proceeding to enjoin A and B from pyramiding unpaid employment taxes is winding its way through the Justice Department and the U.S. Attorney's Office.

Period Ending 12/31/92

The civil suit to enjoin A and B from pyramiding unpaid employment taxes is ready for filing by the Department of Justice. To date, the suit has not been filed because B has filed and paid all monthly returns since August 1992, and A has filed all monthly returns as of September 1992. A decision was made not to file suit until the taxpayers fail to comply with the monthly filing requirements.

Period Ending 3/31/93

Bank levies continue to be served periodically with regard to X18. A and B are continuing to file and pay monthly employment tax returns.

Period Ending 6/30/93

Due to X18's financial situation and the impossibility, of enforcing wage levies, tax delinquency accounts reflecting assessments against X18 due to assertion of the 100 percent penalty have been determined to be uncollectible. B has not yet filed the May monthly return due on June 15, 1993. A1 has not filed a monthly return since January 1993, and claims to have no payroll. A decision was made not to file a suit to enjoin pyramiding of employment taxes owed until there is substantial non-compliance with paying the monthly returns.

MEDIA EVANGELIST: X19

Background Information:	Related Entities/Individuals:
<p>Action began in 1988 with a coordinated examination by EP/EO and Examination Divisions after the Service received news reports and other information about X19's extravagant lifestyle and fundraising. Years 1985 through 1987 for B, were examined. Proposed revocation of the organizations's exempt status is in quality review in the district. Cases against X19's family members were referred to Criminal Investigation Division.</p>	<p>A, a related IRC 501(c)(3) organization. B, a related organization claiming church status. D, a related taxable entity. D1, a related taxable entity.</p>
<p>Issues:</p> <ul style="list-style-type: none"> o Inurement o Unreported income o Exempt status 	

Status:**Period Ending 6/30/92**

Examination of A, for years 1988-1990 is in process. The examination has raised questions about B. A proposed Church Tax Inquiry Notice to B has been prepared and submitted for signature of the Regional Commissioner.

Period Ending 9/30/92

Examination of A, for years 1985, 1986 and 1987 has been completed. A recommendation proposing revocation of section 501(c)(3) status is in review. An examination of the organization's books and records for years 1988, 1989 and 1990 is currently in process. A Church Tax Examination Letter to B has been prepared for the signature of the Regional Commissioner.

Period Ending 12/31/92

Examination of A for the years 1985-1990 is complete. Revocation of exemption is being proposed. The revocation letter is being prepared. An examination of B, is currently in progress. Examinations of employment tax returns of D and D1 for years 1985-1987 have been completed and closed. Taxes and penalties were recovered.

Period Ending 3/31/93

The examination of B has been completed and revocation exempt status is proposed. The revenue agent's final report will be issued concurrently with the proposed revocation letter to A. Examination Division is preparing to examine related individual, corporate, and employment tax returns.

Period Ending 6/30/93

Revocation of the exempt status of A and B will be proposed. The organizations have indicated they will not contest adverse closing action regarding exempt status. Since neither organization has funds from which tax could be collected, no tax assessment action will be taken by EP/EO Division.

MEDIA EVANGELIST: X20

<p>Background Information:</p> <p>X20, assisted by A, tours the United States making personal appearances, as well as radio and television broadcasts. The case examination was initiated by the Service due a review of claims filed by X20 eliminating all net profit originally reported on Form 1040 Schedule C.</p> <p>Issues:</p> <p>o Parsonage Allowance</p>	<p>Related Entities/Individuals:</p> <p>C, X20's ministry. B, X20's sponsoring organization. A, X20's spouse.</p>
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Status:**Period Ending 3/31/93**

This is the first time we are reporting on this case. X20 and A filed Forms 1040X for years 1988-1990, which are under examination.

Period Ending 6/30/93

The claims filed by the X20 and A were disallowed.

MEDIA EVANGELIST: X21

Background Information:	Related Entities/Individuals:
<p>X21 is a media evangelist who has operated throughout the world. His organization, A, has been delinquent in payment of employment taxes. The case is being worked through the Automated Collection System (ACS) function of Collection Division.</p>	<p>A, an IRC 501(c)(3) organization identified with X21.</p>
<p>Issues: N/A</p>	

Status:**Period Ending 6/30/93**

This is the first time we are reporting on this case. Collection Division is attempting to collect employment taxes from A in connection with Form 941 for the period 9303.

MEDIA EVANGELIST: X22

Background Information:	Related Entities/Individuals:
<p>X22 operates his evangelistic endeavors on a world wide basis. His organization owns a ship and planes. X22 owns satellite TV stations over which he transmits his programs. He carries on charitable programs world wide. A has filed claims under IRC 4041 for credits for aviation fuel expenditures. The claims may be denied unless the organizations can show that the fuel was used exclusively for an educational organization.</p>	<p>A, a 501(c)(3) organization controlled by X22.</p>
<p>Issues:</p> <ul style="list-style-type: none"> o Tax credit for aviation fuel 	

Status:**Period Ending 6/30/93**

This is the first time we are reporting on this media evangelist. Returns filed by A for open years claiming a tax credit are under examination.

Chairman PICKLE. Mr. Schoenfeld, do either you or Mr. Sullivan have any statement you want to add to that?

Mr. SCHOENFELD. No, I do not have anything I would like to add to that.

Chairman PICKLE. Mr. Sullivan.

Mr. SULLIVAN. Not at this time, thank you.

Chairman PICKLE. I started to say, we have been given a very broad set of facts here. Well, we are going to start looking at some of these cases in a broad sense, Mr. Owens. So let me ask you a couple questions.

One of the cases you mentioned involved a CEO of a large charity who received a salary, payment of expenses related to his apartment, bonuses, and maid service that totaled well in excess of \$1 million.

You gave us that in one of the cases. How should the salary and the bonuses and living expenses and the maid service be reported on the 990? Were they reported on the 990?

Mr. OWENS. Well, it is my understanding that the items were buried in the expense accounts of the organization on the 990. The maid service and the other benefits were not reported as compensation to the officer involved.

Chairman PICKLE. How could then the form 990 be changed so that the public and the IRS can track the reason for these, quote, "various compensation payments"?

Mr. SCHOENFELD. Mr. Pickle, your subcommittee has helped us focus on the areas in the form 990 that could stand improvement, and we are prepared to share with you some suggestions that we have.

I am prepared to go through the return with you to show you how these fit in, but in general, we do take a look at the form 990 each year. The form 990 is a uniform Federal and State return. The representative from the assistant attorney general of Connecticut, who will be here with you this afternoon, is a member of one of the groups that regularly meets and works with the Internal Revenue Service on how to improve the reporting of the form 990.

We also work with interested tax groups and academic groups, and it is against that background that we can share with you the specific suggested revisions to the form 990 for 1993 that we have in mind. Your staff has copies.

Chairman PICKLE. Well, in copies furnished to our subcommittee it showed that you had a statement with respect to the IRS compliance activities, and I guess this pertains primarily to form 990, does it?

Mr. SCHOENFELD. Yes, and if you would like, I could show you how an example of such a form 990 would be completed and where some of the problem areas in the form 990 are and our suggestions for improvement on them.

Chairman PICKLE. Well, at some point the committee wants it clearly understood that we are looking at alternatives by way of a sanction, such as an excise tax, and a multiple series of recommendations for changes in the 990 to get more information, and several other changes we can get into later.

I think at this time, Mr. Houghton, we might get Mr. Schoenfeld to go ahead with us and make a general statement about how the

990 is used, what you expect, how it is used now, and possible changes and any other recommendations you have. I think if we get more information from the organizations, you can come nearer to knowing what is inurement, for instance.

Mr. SCHOENFELD. We certainly agree with that because the purpose of the form 990 is to provide the means by which the public charity will account to the public for the valuable tax subsidies it receives through exemption, through tax deductible contributions. The return is public.

It is available from the Internal Revenue Service. It is available from the States where the organization is required to file, and—

Chairman PICKLE. At this point then, why don't you go ahead and make your statement about how it is used and possible changes. We will just listen to what you have to say.

Mr. SCHOENFELD. Thank you.

Chairman PICKLE. Are you going to leave us or are you going to go speak?

Mr. SCHOENFELD. I have some charts here.

Chairman PICKLE. I see. While you are covering the charts, Mr. Hancock has a question too.

Mr. Hancock.

Mr. HANCOCK. I understand that you made the statement that the 990 is available to the public.

Mr. SCHOENFELD. Yes, sir, it is.

Mr. HANCOCK. By the words "upon request." That is what I had always thought. But I understood earlier that if individuals just walked into the IRS and said they wanted to see a form 990, they couldn't get it.

Mr. SCHOENFELD. They can request a copy and one will be provided as soon as it is available. They can also get the form 990 at the principal business office of the charity itself.

Mr. HANCOCK. Does that law require those charities to make that information available?

Mr. SCHOENFELD. Yes, the law does and there are penalties for failure to comply.

Mr. HANCOCK. Let me ask you another question. Is there anything in the code that requires 501(c)(3) qualified organizations to make anything other than the form 990 available? In other words, as a contributor, can I ask them for an operating statement, a breakdown of the form 990, in other words, where the figures came from?

Mr. SCHOENFELD. The form 990 does contain what amounts to a profit and loss statement. So that is what is reported, but you couldn't ask the organization for the backup information to the form 990 nor could you ask the organization under present law for copies of certified financial statements that might be prepared for internal management purposes.

Mr. HANCOCK. You could ask for it, but there is no law that requires them to give it to you; is that correct?

Mr. SCHOENFELD. That is correct.

Mr. HANCOCK. I don't know whether you would want to—we have enough laws now, but would it be possible for a 501(c)(3) to qualify, that it would have to agree to furnish an outside audit if in fact some contributor was willing to pay for one?

Mr. SCHOENFELD. That would be a tax policy question. Some States require that, but that certainly is not a rule for Federal tax exemption purposes.

Mr. HANCOCK. Thank you.

Mr. KLECZKA. Mr. Chairman, before you start, Mr. Schoenfeld, to follow up on Mr. Hancock's question, would it not be possible to mandate that charitable organizations under solicitation put a note that a copy of our 990 is available at our office, the IRS or your local State revenue office? Because I have to assume 99.99 percent of the people of this country don't know that.

Mr. SCHOENFELD. You are probably correct. It would be possible to do that.

Mr. KLECZKA. Maybe it is a higher percentage.

Mr. SCHOENFELD. But present law does not require that information to be disclosed in solicitations.

Mr. KLECZKA. But if in fact we are going to start changing 990, which I think, based on some of the testimony we have already heard in closed and open session, should be contemplated, we possibly could add that so the public at least knows when they send their contribution off, if they want to see if it is a bona fide organization, look at the 990?

Mr. SCHOENFELD. That would be your decision to make and whether or not that serves a real purpose or not would have to be measured against the burdens on the organization of complying with that disclosure statement. But that certainly is an option that you—

Mr. KLECZKA. The only burden would be to put it on the bottom of the solicitation. The printer won't even ask for more money for the ink on that.

Mr. SCHOENFELD. It would appear to be a minimal one.

Mr. KLECZKA. But if we are going to state here publicly that not only will you give an audit and the organizations and States and no one knows it is available, what is the sense of even having it available?

Mr. SCHOENFELD. You make a very good point, Mr. Kleczka.

Mr. KLECZKA. Thank you very much.

Chairman PICKLE. The important thing really is to get information on the 990 that would be meaningful to us. At this point, I assume you are saying we could change the form considerably. I just guess that is where you are going to make a suggestion to us now.

Mr. SCHOENFELD. Yes. Let me try to take you through a 990 and show you how it operates. This is the same 990 that is contained in the statement. This is a blowup of the chart. The form—the first page of the form 990 is a summary statement of the revenues of the organization and summary of the expenses and the net assets.

Here we have an example of a media evangelist organization. The media evangelist organization is reporting on lines 1 through 12 its revenues. Line 1 represents the contributions received by the organization and if you will remember a figure I am going to tell you now, you will see how this plays into another figure on page 2 of the return. It will give you an indication of some of the reporting problems that we have.

The first line on the return are contributions, gifts, grants, and similar amounts received from the public. Line 1—D shows \$40 mil-

lion being received there. Now, I want you to pay attention to that number because when we go to the next page, you are going to see something else. This organization has program service revenues of \$2 million, total revenues of \$42 million, \$42 million. Its expenses amount to \$43 million and it is reporting a loss of \$1 million. Now, look at the expenses for the program services. These are the expenses directly in furtherance of the intended purpose of the organization, \$42 million. \$1.5 million additionally is shown as indirect expenses and fundraising expenses are shown as \$500,000.

Let's see where these numbers come from. Here is——

Chairman PICKLE. Is this an actual case?

Mr. SCHOENFELD. No, sir. This is a hypothetical case.

Chairman PICKLE. All right.

Mr. SCHOENFELD. Here we have page 2 of the form 990. Page 2 of the form 990 is a statement of the functional expenses of the organization, which is in effect an expense analysis of the organization, and a statement of the program service accomplishments, a statement by the organization of what it did to justify its tax-exempt status.

Let's look at part 2 of the form 990. It has lines 22 through 44 on it, and you will see total expenses of the organization. The total expenses of the organization are allocated to three areas: the program service expenses, the management and general expenses, and the fundraising expenses, columns B, C, and D, respectively.

Chairman PICKLE. Mr. Hancock.

Mr. HANCOCK. You say that this was not an actual case. Since the form 990 is available, I mean open to the public, how come you didn't bring us an actual case?

Mr. SCHOENFELD. I thought that it would be easier if I made up one that would try to better illustrate the points I intended to bring out.

Mr. HANCOCK. I appreciate that. Thank you.

Mr. SCHOENFELD. And the numbers laid out, they are my fault. What we had here, with the statement of functional expenses, are these things: First, take a look now at the grants and allocation, line 22. This is in the expense portion, the distribution portion of the 990. This is telling the reader where the money is going.

Well, we see here, line 22, that there is \$10 million going into program services. Now, if I didn't prepare the return, you wouldn't know where that is coming from in all likelihood. But since I put this together, I have an asterisk here and we see what this means, the amount shown on line 22, the \$10 million, and it tells us that that represents the fair market value of used textbooks to improve teaching of science in underdeveloped countries.

These are in fact obsolete textbooks. They are not used by any institution of education in the United States, but they have been donated to the organization and the organization has distributed these to students in underdeveloped countries. Well, what is the 990 issue here? What is the problem here?

Well, you see this \$10 million. This \$10 million is included in the \$40 million on page 1, part 1, line 1 of the form 990. What happened in this case was that the organization received used obsolete textbooks. It valued these at \$10 million. Without doing anything

else, it turned around and distributed the textbooks to another organization or to students in an underdeveloped country.

What does this do for purposes of the 990? The only purpose of this transaction was to inflate and distort the way in which the contributions were received, and the way in which they were reportedly paid out in this particular case. I am trying to show you that the problems that arise in this kind of case for the reader of the return. A reader of the return would not ordinarily be aware of the potential for the abuse because of the inflation of the books received at an inflated value. One of the suggestions, therefore, that we have and that we are sharing with you here is to delineate the cash and the noncash amounts with respect to the contributions received and the grants and allocations that are paid out.

In the suggested revisions that we have here, and we are not even sure which version is better there, we have a couple of ways of dealing with the problem, but the bottom line on it is that there would be a separation between the cash and the noncash items.

So the reader of the return would be able to discern how much is cash and how much is noncash just from looking at the return.

Mr. HANCOCK. Pardon me. The benefit here actually inures to the person that donated the book. It doesn't really benefit the charity in this case, but somebody got a \$10 million writeoff for something that wasn't worth anything.

Mr. SCHOENFELD. That could be a problem too, Mr. Hancock, yes.

Mr. HANCOCK. In the case you are discussing here, it seems to me that is the biggest problem, that taking a bunch of paper that isn't worth anything and getting some charity to recognize it as a \$10 million gift. They can then take a \$10 million charitable deduction.

Mr. SCHOENFELD. That would be an issue that our agents would be looking into and, as you heard from the summary of Mr. Owens, there are some organizations that actually transfer these goods from one to another without any of the organizations necessarily adding value to the transaction.

Mr. HANCOCK. But in this situation that we are looking at, Mr. Chairman, we need to look at the benefit not only to the charity, but the benefit to the people that are making charitable contributions. I remember at one time a situation occurred where people would buy Bibles for \$2 and then 5 years later, they would donate them for \$50 apiece. I believe the Internal Revenue Service finally caught up with that one, but a lot of money was made on that.

Mr. SCHOENFELD. We are just trying to portray now how some of these issues are, or are not, reflected on the form 990 and what some of the weaknesses may be about present reporting and our suggestions for improvement.

Line 25 is the compensation for officers and directors here. The amounts here are the total amounts that are actually paid in this particular case.

There is a total compensation for the officers, directors, and trustees in this particular example. The officers are minister A, his wife, and his elderly mother, and they receive total compensation of \$1.2 million. Now, of that \$1.2 million, \$1 million is allocated to program service expenses.

One of the problems in understanding the form 990 has to do with how much is allocated between program service expenses and how much is allocated as fundraising expenses. Last year, a revision was made to the form 990 and it is this section in here relating to the reporting of joint costs. If an organization conducts a combined educational and fundraising solicitation, it has to check a yes or no, and if it is yes, it has to tell you the aggregate amount of the joint costs, in this case, \$4 million, how much was allocated to program services, \$3.5 million.

That would be included in this figure over here, and \$250,000 was included as fundraising expenses. The problem here is that what is used to allocate expenses is a reasonable allocation, and from an Internal Revenue Service standpoint, the disclosure of these amounts are what we focus on. This is a new part of the return that was introduced in 1992 to increase public understanding of the fact that expenses in program services could represent the joint costs of a fundraising solicitation as well as an education campaign.

Part 3 of the form 990 probably represents the most important part from the organization's standpoint of providing accountability to the public. It shows here that the major purposes of the organization are the broadcasting of inspirational messages and it is also reporting the educational program to teach science to underprivileged children in undeveloped countries.

This \$10 million in this particular example represents the same \$10 million that we talked about before, the used textbooks. Page 3 is the balance sheet of the organization. The balance sheet of the organization shows the beginning of year assets and the end of year assets, and what this example is trying to portray is that there are items that our agents need to look for, need to analyze for purposes of determining whether or not inurement or private benefit might exist in a particular case.

Here, in this case, the hypothetical facts tell us that the chief executive officer of the organization had a wardrobe prepared for him at a cost of \$400,000, that there was a parsonage built for \$2 million, and that there was a broadcast studio built by the son at an exorbitant rate here. All of these would not be revealed on the 990 except usually as land, building and equipment on a gross basis. You would not regularly see that breakdown on a regular form 990.

Chairman PICKLE. Mr. Schoenfeld, how many more of these forms can you show? We have a vote that has been scheduled. Can you summarize this?

Mr. SCHOENFELD. OK, let me show you now part 5, page 4. Here we have that section of the return that requires the listing of the compensation that is paid to the officers, directors, trustees and key employees. Here the name and address of the officer, or director, or employee is shown, the title, the average hours, the compensation that is paid, the contributions to employee benefit plans, and the expense allowances to the organization.

I am going to skip over page 5 of the return, which has to do with the analysis of income-producing activities. I am going to go to—because of your interest in the area of inurement and private benefit, I want to refer you now to page 1 of schedule A. This is that part of the return that is to be completed only by charitable

organizations. Here we have the five highest paid employees being listed here, and we also have the five highest persons who provide professional services.

We have had problems with regard to what we call the disaggregation of salaries in exempt organizations and you will see here, on page 4, we say that any officer, director, trustee, or key employee receive aggregate compensation of more than \$100,000 from your organization of which more than \$10,000 was provided by related organizations, that is required to be provided if the person receiving the compensation was an officer, director, trustee, or a key employee.

The problem was that we found that some organizations did not want the total compensation paid to an employee to be reflected in one place and allocated the salaries to various related and affiliated organizations. So what we have here is a rule that requires the reporting of these amounts in one place, provided that the \$100,000 and \$10,000 rules are satisfied.

We are suggesting that those rules to prevent disaggregation of salary reporting be made applicable also to the amounts that are shown here for compensation of the five highest paid employees.

There is one other area of the return that affects inurement and private benefit. That is question 2 of part 3 of form 990. Here the organization has to answer questions about whether during the year the organization directly or indirectly engaged in any of the following acts with its trustees, directors, principal officers, or creators or any taxable organization or corporation with which the person is affiliated as an officer or director, trustee, majority owner or principal beneficiary, and we list A through E and it goes through various transactions, sale exchanges or leasing of property, lending of money, et cetera.

What we are contemplating, and we have this in the proposed revision, is to try to strengthen this reporting and we are considering giving it greater prominence in returns for 1993. Because these are proposals, we need to consult with the States and to the extent they would involve recordkeeping burdens upon the organization, we would have to give consideration to putting these changes out in proposed form as well.

Chairman PICKLE. All right, now, Mr. Schoenfeld, you have given us an outline of a hypothetical case and the problems that you have in trying to get information and the question that is raised in its operation and its reporting.

To me that is hypothetical and I have a general idea of it. What we need to have from you now, since you and I are committed and will be working together, is what changes can we make? What forms can we have that would give us more accurately the information that we think the public is entitled to?

Now, we don't have time for that at this point. I mean, we haven't got time to go into it at this point, but we will come back to that at a later point.

Before we adjourn, Mr. Brewster.

Mr. BREWSTER. Mr. Chairman, I had four or five quick questions I would like to ask.

Chairman PICKLE. All right.

Mr. BREWSTER. Now, we are fairly short on time to vote. Should we take like a 20-minute recess and come back or——

Chairman PICKLE. We are going to do that. How much time? We have one vote that follows. I believe that is all. So why don't we do this: At this point, we will have a recess of say 15 minutes approximately, because I think by that time we will have had the first and the second vote. We will say 20 minutes. That gives us time, I believe, and we will stand in recess for 20 minutes.

Now, when we come back, Mr. Brewster, you can ask your questions, but I want to go immediately forward. I want to go to the attorney general from Connecticut. Is he still here?

Mr. ORMSTEDT. Yes, sir.

Chairman PICKLE. Can you stay with us at this time?

Mr. ORMSTEDT. Yes, sir.

Chairman PICKLE. I want to also turn to a statement the attorney general from Texas has given to the committee too. We will come back in 20 minutes, and then get these two statements, and come back for any questions you want.

All right, we will recess then for 20 minutes.

[Recess.]

Chairman PICKLE. The committee will resume at this time. I am going to ask Mr. David Ormstedt, assistant attorney general representing the State of Connecticut, if he will take his position. Mr. Ormstedt, are you there? Good.

And these other gentlemen can remain where they are. I am sorry for this delay of your testimony, but we would like for you to go ahead at this point. When you finish, I will make a comment from my State attorney general if I could get my copy here.

All right, Mr. Ormstedt, if you would go ahead, we are glad to have you here.

STATEMENT OF HON. RICHARD BLUMENTHAL, ATTORNEY GENERAL, STATE OF CONNECTICUT, AS PRESENTED BY DAVID ORMSTEDT, ASSISTANT ATTORNEY GENERAL

Mr. ORMSTEDT. Thank you, Mr. Chairman. I am an assistant attorney general from Connecticut, in charge of the Charitable Trusts and Solicitations Enforcement Program for Attorney General Richard Blumenthal.

My attorney general is chair of the Charitable Trusts and Solicitations Subcommittee of the National Association of Attorneys General. We thank you for this opportunity. The work you are doing today, and I am sure you will be doing in the future, is extremely important.

I have submitted to the subcommittee the written statement of Attorney General Blumenthal and I ask that it be made part of the record.

Chairman PICKLE. Well, the entire statement will be made a part of the record.

Mr. ORMSTEDT. Thank you, Mr. Chairman. My State is typical of most States in that we have a program that regulates organizations that fundraise from the public. These programs have three basic components.

We require charities to register with our offices and file annual financial reports. We also attempt to prosecute and deter fraud and misrepresentation by charitable organizations.

We also have a public information function that attempts to disseminate information to the public in an understandable format about the activities of charitable organizations in Connecticut. Mr. Chairman, when I assumed responsibility for this enforcement program 20 years ago, it was very much a part-time job for me.

Now it is a full-time job, not only for me, but for two other assistant attorneys general. I think I have one message for you today and that is, the horse is out of the barn and it is trampling on the crops.

If you and your committee, Mr. Chairman, are concerned that something needs to be done but perhaps are afraid that what you might do would somehow harm legitimate charities, or that perhaps the problem is not big enough to warrant additional legislation, I would urge you not to be that concerned.

The problems are enormous. The American public does not realize it, the giving public does not realize it, and I think in my view, and that view is with 20 years of experience, that if something is not done very soon, the public, the donors, and the Treasury will continue to be ripped off.

I want to be absolutely clear, Mr. Chairman, that the majority of charitable organizations are fine, upright, and operated by people who have the best public interests at heart.

Chairman PICKLE. And we would agree with you, Mr. Ormstedt.

Mr. ORMSTEDT. Thank you. And while there have always been some bad apples, over the last 10 or 20 years, their numbers have swelled and their brazenness has grown. Imaginative people are constantly finding new ways to push the envelope, all with the imprimatur of the U.S. Government.

It is not that these organizations are breaking the rules, Mr. Chairman. The rules, unfortunately, do not in practice prevent misconduct. Now, the statement I have submitted to this subcommittee offers some suggestions for changes in Federal law that might help the horse get back into the barn.

These are rough ideas, certainly subject to further development and subject to questioning, but my office and the National Association of Attorneys General stands ready to work with the committee on these issues.

Now, I am sure you will hear, if you haven't heard already from the charities, who will tell you that new initiatives, no matter what they are, will raise havoc with legitimate charities, increase administrative burdens. The objective, of course, is to paralyze this subcommittee into inaction.

Mr. ORMSTEDT. I submit that inaction by this subcommittee will be far costlier to the public interest than any action you may take.

Chairman PICKLE. Who do you think is trying to push us into inaction? What organizations?

Mr. ORMSTEDT. Well, I believe—by names specifically? I am not sure I would be willing to—

Chairman PICKLE. What type of organization? You said that there are going to be some out there who are going to be pushing us for inaction.

Mr. ORMSTEDT. Some of the types of organizations described in the statement of the attorney general, those that have contracts with professional fundraisers, be they direct mail houses or large, paid telemarketing firms that receive enormous fees from the charities and for doing those telemarketing services and direct mail services. It is a very lucrative industry and anything that infringes on that will hurt their business. I am sure the charities will be urging you not to take any action that would curtail that activity. That is just one example.

I think the charities will also tell you that charitable solicitation is free speech protected by the First Amendment and certain Supreme Court decisions. Well, that is true, but it is besides the point here, Mr. Chairman. We are talking here about tax policy. There is no constitutional right to be free from taxation. The Government can and should provide reasonable and objective criteria to ensure that exemption is obtained and retained only by those that provide some tangible benefit to society.

That is my brief opening statement and I will be very happy to answer any questions you may have.

[The prepared statement follows:]

**TESTIMONY OF THE RICHARD BLUMENTHAL
ATTORNEY GENERAL
STATE OF CONNECTICUT**

I thank Chairman J. J. Pickle and the members of the Subcommittee on Oversight for offering me the opportunity to assist the Subcommittee with its review of the administration of Federal tax laws applicable to public charities exempt from taxation under section 501(c)(3) of the Internal Revenue Code. As Attorney General of Connecticut and as chair of the Subcommittee on Charitable Trusts and Solicitations of the National Association of Attorneys General, I understand the importance of this issue to the American public. I hope my testimony will help your Subcommittee strengthen the capacity of the Federal government to combat fraud and other abusive tactics perpetrated in the guise of charity.

I want to emphasize at the outset my high regard for the spirit of philanthropy that exists among the American people. Voluntary action to alleviate suffering and to address societal concerns has been, and I hope will continue to be, a source of our nation's strength. In recent years, however, we have witnessed a steady growth in the number of people and organizations that are willing to abuse the generosity of the public and flout Federal and State laws that provide generous benefits to charities. This has and will continue to erode public confidence in our philanthropic institutions. Unfortunately, the nation's philanthropic leaders have not stepped forward to condemn the practices and develop effective self-regulation. That is why these hearings, and vigilant law enforcement by both State and Federal agencies, are imperative.

Chairman Pickle has asked me to provide information on five specific areas: Public Accountability, Abusive Practices, Private Inurement, Enforcement Activity and Administrative Matters. I will address them in that order.

Public Accountability

Connecticut and approximately 40 other states have statutes that regulate public charities. While varying in detail, the statutes generally have three objectives: the registration and annual financial reporting by charities, a prohibition on false and misleading fund-raising practices and the dissemination by the State of information to the public about registered charities.

Connecticut has approximately 4500 charities registered, of which about 2400 file annual financial reports. Exempt by statute from the financial reporting requirements are: religious organizations, educational institutions, hospitals, government instrumentalities, and charities that normally receive less than \$25,000 in contributions annually. The number of charities registered and the number filing annual reports have both doubled in the last five years.

Registration entails the filing of basic information about the charity, such as its name, principal address, names of directors and officers, its purpose and whether the IRS has determined the charity to be exempt from taxation. Because it is a registration and not a licensing statute, there is no application and review process. A charity may commence soliciting as soon as it files a completed registration statement. It is not a pre-condition to registration that the Internal Revenue Service determine the organization to be exempt from taxation pursuant to section 501(c)(3) of the Code. A charity must register before it begins soliciting in the state. The registration remains valid unless revoked by the State or withdrawn by the charity.

Each registered charity must annually file a financial report. In Connecticut, the financial report consists of a copy of the charity's IRS Form 990 or Form 990 EZ, information about the use of professional fundraisers and, if the charity had revenue in excess of \$100,000, a set of audited financial statements.

A charity's registration material and annual financial report are public record, available to anyone upon request. Except for information acquired by my office pursuant to a criminal investigation, all other documents we obtain concerning a charity are public records subject to disclosure under the State's Freedom of Information Act.

I consider the dissemination of accurate information about charities to be an important service of my office. Therefore, we routinely review financial reports for completeness and accuracy. Approximately 20 percent of the reports filed are returned to charities for correction because they are clearly incomplete or inaccurate in some material respect. In our opinion the number of inaccurate reports being filed is probably much higher; but because we are able to audit only a few charities each year, many go undetected. Charities that willfully file an inaccurate financial report are subject to prosecution.

My office has consistently maintained that an informed and educated public is one of the best defenses against abusive fund-raising practices. Thus, we have instituted a number of measures to better inform the public about the activities of charities. For example, we prepare a "Fact Sheet" on each charity that files an annual financial report. The sheet provides summary financial information about the charity in a concise, understandable format. Also, for the past six years we have annually published a report on Connecticut charities that hire professional telephone solicitors. The latest report, issued last month, reveals that the solicitors turned over to the organizations that hired them an average of only 30% of the money donated by generous Connecticut citizens. This means that 70% of the money contributed was used for other than the programs people thought they were supporting.

Our public education efforts have been hampered by the often poor quality of financial reporting by charities. We must receive, and the public is entitled to have, accurate and timely data. Unfortunately, the data supplied by many charities is neither accurate or timely. I will discuss this point more fully below.

The Subcommittee has inquired as to the standards, requirements and procedures of Connecticut's taxing authority for the grant, denial or revocation of exemption from State taxation. In Connecticut, exemption from corporate taxation, sales and use tax, and local property tax is linked to Federal tax status. Thus, if the IRS has granted 501(c)(3) status, State exemption will almost inevitably follow. This is just one more example of the ramifications of IRS action - or inaction. Conferring tax exempt status is not only the equivalent of the "Good Housekeeping Seal of Approval" for the donating public, it is also the ticket to tax free income everywhere. If tax exempt status is granted almost routinely, with little or no meaningful standards or criteria to satisfy, there will be widespread feeding at the public trough by those with voracious appetites for personal - not

societal - enrichment.

Abusive Practices

Fraud and chicanery by those acting in the name of charity is disturbingly common. The incidence of these practices, and the imagination of those who engage in it, have increased dramatically over the last decade. Unless mitigated by concerted State and Federal action, the spirit of philanthropy and voluntarism will be slowly destroyed. The following outlines problems faced daily by State Attorneys General.

- Nearly all States that regulate charities rely on the IRS Form 990 for financial information on charities. Indeed, the 990 is becoming the standard source of such information for donors, grant-making foundations and governments. Tragically though, the quality and reliability of the 990 data is poor. Three factors contribute to this: First, the IRS instructions for completing the 990 permit charities to complete the form using any method of accounting they choose. An accounting rule, sanctioned by the accounting profession at the urging of charities, permits much of the cost associated with fund-raising to be credited to the program service function on the Form 990. Thus a charity can mail a request for money, pack it with words with alleged educational value, and claim on their Form 990 that most of the cost of the fund-raising mailing was really to fulfill the charitable purpose for which the IRS granted them tax-exemption. This is so whether or not anyone sent the mailing ever opened it. Second, the error rate for completing the 990 is unacceptable. Three years ago my office conducted a study that revealed that two-thirds of the 990's filed in Connecticut contained one or more arithmetic errors. The extent to which these errors were intentional or the result of carelessness is unknown but nonetheless astonishing. Third, it is clear that very few are paying attention to how charities fill out the 990. The IRS is not, and only a handful of states have the resources to do so. It is not surprising then that the integrity of the 990 data is suspect.

- Some so-called charities seem to exist more for the benefit of their officers and professional fundraisers than for the benefit of a public in need of the services they should be providing. As stated earlier, my studies have shown that fees paid to professional fundraisers can consume most of the dollars people contribute. What little money is left for the charity may simply be used to pay the salaries of the people who run the charity.

- In the quest for contributors' dollars, some tax-exempt organizations exaggerate their accomplishments and the need for their services. There is no doubt about the pressing needs of our society. There is, however, considerable doubt about the ability or desire of some organizations to meet those needs and whether the American taxpayer should be subsidizing them.

- Charities receive considerable benefits and favors from government such as tax-exemption and reduced postal rates. It is not unreasonable to ask that in return, charities openly account to government and their donors. All too often, however, charities withhold information by refusing to make copies of their 990's available and by refusing to reveal information on salaries and benefits.

Inurement

Connecticut, like other states, has no statutory standards for what constitutes reasonable or unreasonable compensation and benefits. At best, excessive compensation can be challenged only on a case by case basis by showing that under the totality of the circumstances the salary paid was clearly imprudent. It is a difficult burden of proof to meet.

My office has filed lawsuits against individuals who have operated charities for private gain. One person who set up several "charities" for causes such as drug abuse prevention and soldiers of the Persian Gulf War openly bragged that he only wanted to make a living. Our suit alleges that the charities provided no benefit to the public.

Private inurement is, however, more than just excessive salaries and perquisites. Professional fundraisers and so-called consultants can reap generous monetary rewards in the name of charity. Under existing State and Federal law, and with existing State and Federal resources, very little is being done to curtail the practice.

Enforcement Activity

I have a very active enforcement program. My office has initiated civil and criminal prosecutions against individuals and organizations for soliciting without being registered, for failure to file required annual financial reports, for filing false financial reports, for misrepresenting the purpose for which donations were solicited and for spending little or no money on charitable programs. It is patently obvious, however, that a strong, coordinated Federal and State enforcement effort is needed to increase compliance with existing law and to reduce the incidence of fraud in the name of charity.

State enforcement efforts are constrained by three U.S. Supreme Court decisions in the 1980's that conferred pure First Amendment speech protection on charities and their professional fundraisers. Under these decisions, States are prohibited from setting any limit on how much a charity can spend on fund-raising and administrative costs, or, conversely, from establishing any minimum amount a charity must spend providing services to the public. States are also prohibited from requiring charities or their professional fundraisers to disclose to the public during the course of a solicitation how much of the contribution will actually be used for the intended charitable purposes. Moreover, the decisions raise doubt about whether States have the authority to revoke a charity's registration even for the most egregious violations of the public trust.

My office's enforcement and public education efforts have been effective. Yet the national scope of charitable fund-raising calls for a greater Federal presence, particularly with respect to the Internal Revenue Service.

Before suggesting changes to Federal law that will help curtail some of the abuses I have identified, I will commend the IRS for three recent initiatives. The Form 990 has recently received two significant improvements urged by the States. First, not only must the salaries and benefits paid by the filing charity be disclosed on its 990, but now any salaries or benefits paid to those same people by closely related organizations must be included. The objective is to

prevent charities from hiding the true salaries of their key people by splitting the payment between two or more affiliated entities. Second, if a charity allocates any of the cost of an activity partly to program and partly to fund-raising or administration, that fact and the amounts involved must be disclosed on the 990. Third, the IRS has vigorously pursued the revocation of exempt status of a charity that allegedly existed primarily for the private benefit of its professional fundraiser.

While these are welcomed developments, they will have only an incidental effect on abusive practices in the name of charity. I suggest the following as areas this Subcommittee may wish to explore:

- Whether current law on qualifying for exempt status too often permits, indeed mandates, the granting of tax-exemption to organizations whose benefit to the public is illusory. Exemption from Federal corporate income taxation is a privilege the government confers on nonprofit organizations that provide useful goods or services to the public that for-profit firms, given the nature of the market economy, are unable to provide. Tax exemption is not a constitutional right. However, the ease with which exemption is obtained and retained makes it the functional equivalent of a right. Consider that from 1982 to 1992 the number of 501(c)(3) organizations on the IRS master file grew from 322,826 to 546,100, an increase of 69%. Of 36,838 organizations that last year submitted completed applications for tax exemption, over 98% were approved. It seems that tax exemption should be conditioned on something more than access to an accountant or lawyer who can fill out the application.

- The IRS should be required, and provided with the resources, to conduct regular periodic reviews to determine whether an organization continues to perform the public service for which it was granted exemption in the first place. There are some states with sufficient resources to conduct limited audits. Perhaps Federal law can be changed to permit the IRS to deputize State charity regulatory officials in appropriate cases, so that the States may have at their disposal more expansive investigatory authority over interstate charities.

- Current Federal law requires that charities classified as Private Foundations annually distribute for charitable purposes a minimum of 5% of their net assets (with certain exceptions). An excise tax is imposed on the foundation if the minimum distribution is not made. The purpose is to ensure that money donated to those foundations is actually spent for the public benefit. Perhaps a similar minimum pay-out for public charities should be required. Some of the more egregious abuses would cease if public charities had to spend over time even as little as 50% of their annual income for purposes other than management salaries and payments for fund-raising related services. A portion of the excise tax on under-payments could be allocated to States that perform audit services for the IRS under the deputy program suggested above.

- A more modest result of these hearings could be a requirement that the IRS prohibit charities from claiming as program service costs on their 990's more than a certain percentage of expenses associated with a fund-raising or management activity.

- Section 6104 of the Internal Revenue Code should be changed to permit the IRS to share investigatory information with appropriate State officials, something which is now prohibited. If an IRS audit examination reveals waste, fraud, or mismanagement, State Attorneys General should be able to have access to the IRS' evidence.

Administrative Matters

I have assigned two and one-half full-time attorneys, one full-time auditor, and one-half of a full-time paralegal to administer my public charity registration, information and enforcement program. (One and one-half full-time attorneys and the remainder of the paralegal's time are devoted to charitable trust and private foundation enforcement.) With the number of public charities we monitor having increased by 122% in six years, it is a daunting task. Our effectiveness and the effectiveness of the IRS could both be enhanced if some of the measures suggested above are enacted.

I thank Chairman Pickle and the members of the Subcommittee for the opportunity to testify. If you or your staff need any further information, please feel free to contact my office at any time.

Chairman PICKLE. Well, I thank you and I am glad to have your whole statement. We are going to read it over.

Does your statement give any example of what is happening in Connecticut by way of specific allegations, specific practices?

Mr. ORMSTEDT. The statement does not, but I can give you some now if you like.

Chairman PICKLE. Yes.

Mr. ORMSTEDT. We have sued an organization that was formed for brain tumor research. The organization was in existence about 2 years and did some considerable fundraising, including by way of polo matches. People were urged to contribute large amounts of money to the organization for the benefit of brain tumor research.

We investigated and found that over the course of about a 2-year period that the organization was in existence, about \$400,000 was raised from the public for brain tumor research. The amount of money that was actually used for brain tumor research was \$5,000. The rest of the money went to all sorts of costs of putting on these polo matches, of raising the money, of providing an office for the person who ran the foundation.

More money was spent for ice sculptures to be displayed at the polo matches—at the luncheons for the polo matches—than was given to brain tumor research. That is one example.

Another organization—

Chairman PICKLE. Will you give the committee the name of the organization? Is it publicly disclosed?

Mr. ORMSTEDT. It is, yes. I am trying to think of the exact name.

Chairman PICKLE. If you will furnish that.

Mr. ORMSTEDT. I certainly can. It is something Ewing Foundation for Brain Tumor Research and I can get the exact name for you.

[The information follows:]

Trevor B. Ewing Foundation for Brain Tumor Research.

Mr. ORMSTEDT. Another organization we sued, the name of it was—this would go back several years, but I think it is one of the better examples—was called the Genie Project. It was to raise money to grant the last wishes of dying children. They obtained a 501(c)(3) status from the Internal Revenue Service. The organization spent most of its money raising money from the public. At its peak, it was raising about \$400,000 a year from Connecticut citizens. They had been in business about 4 years, although they had not always been at that \$400,000 level.

Our investigation determined that of their total income over a 4-year period, about 4 percent was actually spent in any way, shape, or form to grant the last wishes of dying children. Most of the money was spent on the office for the officers and directors, for their travel expenses, travel which had no connection with the charitable purposes of the organization.

Chairman PICKLE. Does the Internal Revenue Service have this information?

Mr. ORMSTEDT. The Internal Revenue Service revoked the exemption of that dying wish organization. We do provide the Internal Revenue Service with information that we have on charities. My understanding, at least what I have been told and I think it

is true, is that the Tax Code prohibits the IRS from sharing information with the States unless the IRS actually revokes an organization's exempt status. We provide information to the IRS and we don't know what the IRS does with it because they are prohibited by law from telling us what they are doing with it.

Chairman PICKLE. We have had that same trouble this afternoon, too.

Mr. SCHOENFELD. But we thank Mr. Ormstedt for sending us the information.

Chairman PICKLE. Well, it is a riddle. How do you proceed? Do you have any other examples or are those typical?

Mr. ORMSTEDT. Another example I can give you, a recent example, was of an organization that was raising money to provide counseling to unemployed and homeless Vietnam veterans. That organization in the last 2 years of its existence was raising about \$350,000 a year from the citizens in Connecticut and had been in existence for about 6 or 7 years. Their total income from Connecticut residents over the period of their existence was about \$1.6 million.

I guess the best thing I could say about the organization is that it provided a place for veterans to drink. It provided virtually no services of any tangible value to these veterans. Most of the money again went to fundraising expenses, payments to its telemarketers. That consumed about 85 percent of the money raised. Of the other 15 percent, a lot of it was spent down here in Washington for hotel rentals, for meals, for renting videos for watching on the television in the hotel, vigils at the Wall, but no services for the purposes for which the money was raised and that is providing housing and counseling for homeless vets, et cetera.

Chairman PICKLE. Well, Mr. Ormstedt, I am going to submit for the record the complete statement of Hon. Dan Morales, attorney general of Texas. I will make copies available to anyone who wants it or the committee will have a copy. I am going to pick parts of his testimony and read it publicly and it may be along the lines of the examples you have given. You may want to later respond to me whether you have the same kind of problems in Connecticut. So let me take from the statement submitted by Texas attorney general some of the questions and his answers, the suggestions he made.

[The information follows:]

WRITTEN STATEMENT OF TEXAS ATTORNEY GENERAL DAN
MORALES
Austin, Texas
July 29, 1993

Chairman Pickle and members of the Committee on Ways and Means,
Subcommittee on Oversight:

Thank you for the opportunity to address these very important issues of administration of and compliance with laws applicable to tax-exempt public charities. I regret that I am unable to address the Subcommittee in person and hope that the members will find this written response to Chairman Pickle's question helpful. I wholeheartedly support your efforts to examine the law of tax-exempt public charities, application of and compliance with those laws. It is extremely important that public charities actually use the benefits they receive from their tax-exempt status to further their charitable activities and not for personal gain or aggrandizement.

We know that the vast majority of charities are operating under very difficult financial conditions to fulfill their important charitable purposes, however, there is a small minority of charities that are clearly abusing their favored status under the law. To protect the public from abuses by this small minority, all of us - federal, state and local authorities - must assure that the laws adequately provide for such protection and that we aggressively enforce those laws.

Following are answers to each question raised by Chairman Pickle in his request for information from the Texas Attorney General.

PUBLIC ACCOUNTABILITY

Q What is your state doing to give donors additional information about public charities in your State?

A: Because Texas has no law which requires public charities to register with the state, the state has very little information about specific public charities in Texas. Our office helped draft and support a bill in the most recent session of the Texas Legislature that would have required Texas charities to file a copy of their Form 990 with the state so that basic financial information would be easily available to the public. This bill was opposed by certain religious organizations in the state and did not pass. We believe that the Form 990 is a good vehicle for providing public information about the financial operations of charitable organizations and support state/federal cooperative efforts to continue to improve the form itself and the quality of reporting it provides.

Q: Are there other sources of information and, if so, how accessible and helpful are they to the public?

A: Given the current lack of publicly available information in Texas, we rely heavily on voluntary provision of information by charities and upon private sources of information such as the Better Business Bureau's Philanthropic Advisory Service and the National Charities Information Bureau. According to the Internal Revenue Code, a charity's Form 990 is available through the Internal Revenue Service. However, it has been our experience that it usually takes months for the IRS to respond to a request for a Form 990 and on several occasions in the recent past, the IRS has been unable to locate a requested form. We are well aware of the lack of resources and personnel in the IRS' Exempt Organizations area and do not mean to belittle the hard work of its employees. This illustration is simply to point out that publicly available information is extremely limited in Texas.

Q: What information do you require from a public charity that registers to fund-raise in your State? What information is required on the annual tax return filed by public charities with the State? Do you require any information in addition to that required by the Form 990? What does State law provide with respect to public disclosure of registration and annual report information? What sanction is available in cases where a tax-exempt organization has filed an incomplete or false annual financial report?

A: These questions are inapplicable to Texas because there is no state law that requires charities to register in Texas.

Q: What information can you provide about the standards, requirements, and procedures of your State's taxing authority for the grant, denial or revocation of State tax exemption?

A: The Texas Comptroller of Public Accounts grants exemptions from franchise and sales tax to organizations which have applied for such exemptions on the basis that they are exempt from federal taxation under section 501(c)(3) of the Internal Revenue Code.

Q: To what extent are you permitted by law to publicly disclose information about an investigation?

A: There is no state law that restricts the Attorney General's ability to publicly disclose information about an investigation. At the discretion of the Attorney General, information concerning an investigation may be protected from public disclosure during the course of an investigation. Generally, we consider it important for the public to know what charitable organizations the Attorney General is investigating although we recognize the importance of not sensationalizing an investigation.

Q: What changes to Federal law, or the Form 990 and its instructions, would improve the availability and quality of information to the public?

A: Our office has worked closely with the IRS through the National Association of Attorneys General and the National Association of State Charity Officials to ensure that the Form 990 provides useful and accurate information to the public. Changes to the 1992 Form 990 concerning the reporting of executive compensation by related entities and joint cost allocation are helpful in providing a more accurate picture of a charity's financial operation. It would be helpful, whether through changes in the law or simply increased funding, if the IRS was required to and had the resources to respond more quickly and completely to requests for public information.

2. ABUSIVE PRACTICES

Q: Please identify what you believe to be abusive practices of public charities. How pervasive are these practices?

A: The vast majority of charities operate within the law and provide valuable services to their communities. There are however serious abuses. Some of the abuses we have encountered recently are:

1. Non-functioning or ineffective boards of directors who either actively participate in the abusive practices or neglect their duties to the charity allowing the abusive practices to continue.

For example, the board of directors of Children's Transplant Association, a Texas based 501(c)(3), held funds in trust for the benefit of particular transplant patients whose families and communities had raised the money. One member of the board of directors and his wife, a paid staff person, controlled the funds and, according to the report of the court appointed receiver, during the course of the last two years, over \$400,000 was used for other purposes. Now the charity is in bankruptcy and the families who were relying on those funds have nothing. The remaining members of the board of directors apparently took no interest in how the organization was being operated or how its funds were being spent until most of the money was gone. (We recognize that it is questionable whether a 501(c)(3) can accept donations to be held in trust for the benefit of a particular person and have reported this matter to the IRS Exempt Organizations Division in Dallas.)

Another example is a Dallas based 501(c)(3) which, under the guidance of its founder who was also a board member and a salaried employee, spent inordinate amounts of money on lavish fund-raising events leaving nothing for charitable pursuits. In that case, some board members were paid for services rendered to the fund-raising events and some simply ignored the

situation. When the activities of the founder/executive director were exposed in a local paper, the board members (except the founder) simply resigned.

2. Self-dealing (private inurement) by members of boards of directors and employees

For example, a San Antonio based 501(c)(3) with which we are currently involved in litigation is purportedly a membership organization run by a three person board of trustees (directors). The board is elected annually by vote of the members. The founder claims to be the sole member. As such, he has total control of the board of trustees. The three members now are the founder, his companion and an individual who lives in Connecticut. The founder has removed from the board and sued two previous members who challenged some of the actions of the founder and his companion. Founder and his companion are both salaried (although the salaries are very small). Furthermore, Founder claims that he is entitled by board resolution, a vote of himself and his previous companion, to free room and board at the charity's facility. The charity pays all of their living expenses including car, groceries, weekly maid service, hair coloring, beer and cigarettes. There is no control at all over what they spend. Recently, at the time the charity was sending out a fund-raising appeal claiming it would have to shut down if substantial sums were not raised, founder and his companion traveled to Europe at the charity's expense, ostensibly to attend a meeting of experts in the field. Employees and the removed board members have complained to our office and we have intervened in the litigation and sued founder and his companion for breach of their fiduciary duties to the charity.

In another current case, the three member board consists of a tax attorney, a CPA and a third individual who rarely, if ever participates in the operation of the charity. The 501(c)(3) public charity is ostensibly raising an endowment to open a private high school. To date, all contributions to the endowment have been donations of property such as land and breeding stallions from clients of the lawyer and the accountant. The IRS has issued private letter rulings that the endowment's holding of breeding stallions and a herd of cattle (none of which are located even remotely near the community where the school is to be) are related to the charitable purpose of the organization (and agricultural science curriculum) and therefore gifts are fully deductible by the donor and income from the gifts is not unrelated business income to the charity. We are still investigating this matter, but it appears that the two active board members are creating convenient "tax planning" opportunities for their clients thus enhancing their own practices, rather than attracting suitable donations for an endowment fund.

3. Failure to fulfill the charitable purposes for which the charity was established

One important and systemic example of the failure of charitable institutions to fulfill their purposes is the profit maximizing behavior of some wealthy non-profit hospitals and the refusal of these hospitals to serve the uninsured in their communities.

It is an unfortunate fact that in many Texas communities, like the rest of the nation, tens of thousands of people are uninsured and must rely on overburdened public health systems for the most basic of health care services.

But the public hospitals are not the only institutions that bear some responsibility for health care to the uninsured. Non-profit hospitals also have a duty under the law because they receive what amounts to a public subsidy through tax-exempt benefits and because they are organized for charitable purposes.

The Texas Attorney General filed suit against Methodist Hospital in Houston in 1990 for failure to fulfill its charitable purposes. Methodist Hospital has been a particularly egregious example of the failure to fulfill charitable purposes.

The Hospital claimed that it had no duty under the law to serve poor people. The Hospital cited IRS revenue rulings as one source for its contention that there is no duty under the law to serve the poor.

Meanwhile Methodist Hospital, in the words of Glen Melnick, a healthcare financing expert in this case, and Associate Professor at UCLA:

The Hospital has exploited this [tax-exempt] subsidy to maximize its profits and stockpile a tremendous cash reserve. At the same time, the Hospital deliberately limits its exposure to the needy residents of its community, pushing the burden of providing care to this population on its competing hospitals - both non-profit and for-profit.

A few simple facts illustrate Dr. Melnick's analysis:

- Methodist Hospital's admissions policy excluded uninsured (non-emergency) individuals unless they paid a deposit equal to the entire cost of their care.
- Methodist Hospital devoted less than 1% of its \$500 million gross patient revenue to charity care - an average of only \$5 million dollars per year, compared to over \$40 million in subsidies the Hospital receives every year from tax-exempt benefits. It is interesting to note that over half of this subsidy is a result of federal tax exemption.

- Methodist Hospital earned over \$76 million in excess revenue, that is, profits in 1991.
- Methodist Hospital has accumulated over \$600 million dollars in unrestricted cash reserves.

The Methodist Hospital case was recently resolved after Texas passed landmark legislation that for the first time holds non-profit hospitals accountable to the public for the millions of dollars in tax-exempt benefits they receive. SB 427 requires tax-exempt hospitals to plan for, report, and provide and/or fund specified levels of charity care to their communities. Our office has already received a number of inquiries from other state legislators who are interested in considering such legislation in their states.

Under the new law, Methodist Hospital will provide 4% of net patient revenue, about \$19 million in charity care annually, starting in 1994, an increase of at least \$14 million every year. This is equal to about 100% of their state tax benefits. In addition to complying with SB 427, the Hospital has made a grant of \$250,000 to the hospital district and established a charity care endowment fund with an initial contribution of \$5 million and a pledged contribution from a Houston foundation of \$4 million.

4. Hiding behind "church" status to claim no responsibility for any public accountability or compliance with any regulatory requirements which apply to other charitable institutions.

For example, Robert Tilton, a Dallas based televangelist, has repeatedly refused to disclose financial records to the State of Texas on the grounds that all state statutes which require such disclosure impinge upon the separation of church and state and violate his First Amendment rights to freedom of religion. Despite the fact that his church was organized as a Texas non-profit corporation, received gross revenue of at least \$65 Million in 1991 and that serious questions had been raised about whether money was used for any charitable purposes or for Tilton's own enrichment, a federal district judge enjoined the State's investigative effort. That ruling has been overturned by the 5th Circuit Court of Appeals and Tilton has petitioned the U.S. Supreme Court for a writ of certiorari. The state court proceeding is pending.

Recently, other "church" entities headquartered in California have begun fundraising efforts in Texas. Our office has recently obtained a court order requiring the "California Missionaries", who dress as priests and solicit contributions at the Dallas-Ft. Worth airport, to comply with the State's investigative demand for documents. They have failed to comply and we will seek a contempt order against them, but we still have no information on

whether any of the thousands of dollars they solicit from travelers at the airport ever goes to the orphanages they claim to support.

5. Deceptive fund-raising practices

Texas, like most other states, is plagued with look-alike charities purporting to fight cancer, heart disease, drug abuse, child abuse and other emotionally compelling causes. The most frequent deceptive fund-raising practices we see are:

Giving the charity a name that is deceptively similar to that of an established charity or government agency.

Claiming to offer programs which do not exist or are simply in the "planning stages"

Representing that all or a substantial portion of each contribution will go to the charitable purposes of the organization when in fact it goes to pay the fund-raiser or administrative expenses

Representing or implying that funds raised will be spent locally when in fact the money raised is taken out of state

Q To what extent are professional fund-raisers involved in the practices?

A: Those paid fund-raisers who actually design and conduct the solicitations and control the donations, are involved in most of the deceptive fund-raising practices we encounter. As noted above, however, many of the abuses we encounter are by persons within the charity itself.

Q Have you observed an increase in the incidence of these practices over the past few years?

A: Yes. We have observed a significant increase in high dollar volume fund-raising abuses as the unscrupulous professional direct mailers and telephone solicitors move from the commercial into the charitable arena. We are unable to measure an increase in dollar volume since Texas requires no financial reporting, but the increase in calls to our office and substantiated media reports of abuses clearly indicate that the problem has worsened.

3. ENFORCEMENT ACTIVITY:

Q Describe your State's enforcement program in the area of public charities. What are your enforcement priorities?

A: State enforcement in the area of public charities is handled by the Attorney General's Charitable Trusts Section, a part of the Consumer Protection Division. There are three lawyers, one investigator and one CPA responsible for protecting the public's interest in the approximately 30,000

public charities in Texas. This staff investigates reported abuses by public charities and/or their fund-raisers, attempts to resolve the problems in such a way as to permit the legitimate charitable work of the organization to continue, and if that is not possible, sues the charity, its directors and fund-raiser as necessary. Our enforcement priorities are to stop abuses which keep those who are supposed to benefit from the charities programs from receiving the benefits, to remove those who are profiting illegally from their relationship with a charitable organization, to protect charitable assets, to restructure the operation of public charities to try to ensure that the abuses do not reoccur and to recover misappropriated funds so that they can be used for charitable purposes (although funds are often not recoverable).

Q: Is your enforcement program able to address the abusive practices you have identified? What constraints do you encounter?

A: We are able to address some of the abusive practices we identify. The constraints are many - limited resources including personnel and money, the vast size of the state requiring extensive travel for investigation and the lack of a statutory framework requiring registration and financial reporting to provide the state with necessary background information on charitable activities in the state.

Q: In what areas is the State more active and in what areas does the IRS need to be more active?

A: In Texas, the State is active in all of the above mentioned areas. With adequate resources, the IRS could be more active in the determining whether a charity really is fulfilling the charitable purposes described in its application for tax exempt status. We believe that the IRS, as part of its coordinated hospital audit program should examine not only private inurement and corporate structure issues but also closely examine whether a hospital is fulfilling its true charitable purposes (not restricted to those outlined in Revenue Ruling 69-545) and to what extent it is appropriate for a hospital to accumulate immense cash reserves instead of performing charity care desperately needed by its community.

Q: What changes to federal law, or IRS' administration of the law, would help curtail the abuses you have identified?

A: The IRS should be adequately staffed to allow the agency to review Form 990's for accuracy and to spot red flags. It is our understanding that the Service does not have the resources to conduct even the level of analysis performed on individual tax returns. Thus much abuse escapes detection, especially in a state that does not require the 990 to be filed as a state as well as a federal filing.

The IRS should also have sanctions short of revocation to remedy private inurement. There are many times when the charitable activities can and should continue once the wrong is righted and the wrongdoer removed. It is often not the charity itself, or all of the board members who are at fault and the IRS should not have to choose between destroying the charity or doing nothing.

The IRS should revoke Rev. Ruling 69-545, which has permitted non-profit hospitals to retain their 501(c)(3) exemption despite the fact that they perform little or no charity care.

While we recognize and support the constitutional mandate of the separation of church and state and the need to allow the existence of non-mainstream and unpopular religious practices, the area of tax exempt churches is rife with abuse. The very restrictive IRS guidelines for auditing a "church" should be tightened so that at least the IRS could investigate to determine whether some of the so-called churches are anything more than fronts for the support of an individual or small group of people.

4. INUREMENT

Q What is the law applicable in your state to inurement, private benefit, or reasonable compensation? Do you have concerns about those matters?

A: We have serious and continuing concerns about matters of inurement, private benefit and reasonable compensation. Public charities are established to benefit the public, and while those individuals that carry out the organization's charitable missions are certainly entitled to compensation, they are not entitled to use a charity as their private gravy train.

These matters are governed by the Texas common law of charitable trusts, the Texas Trust Code (*Texas Property Code, Chapter 111 et seq.*) and the Texas Non-Profit Corporation Act (*Article 1396, Tex. Rev. Civ. Stat. Ann.*) Under the common law, the directors and other fiduciaries of a charity have the duty of loyalty which requires that they act always in the best interest of the charity. Neither this common law duty nor any statutory provision, strictly prohibits an individual from receiving reasonable compensation for goods provided or services rendered to the charity. It does, however, require that any compensation paid or benefit received by an individual must benefit the charity first and foremost. The Non-Profit Corporation Act prohibits payment of dividends or distribution of income to members, directors or officers. The statute provides that "A corporation may pay compensation in a reasonable amount to its members, directors, or officers for services rendered, may confer benefits upon its members in conformity with its purposes. . . ." (*Article 1396-2.24*) Loans to directors are prohibited (*Article 1396-2.25*). There is no statutory framework or case law offering guidelines as to what is reasonable compensation. When reviewing a compensation issue, we have

used comparative salary studies and expert testimony to determine if compensation is reasonable. We focus not only on the amount of compensation, but the process used to set it.

Q: Can you describe any recent State actions related to inurement?

A: Yes, the two cases described above as examples of self-dealing. In the first case, we are seeking the appointment of a receiver or special master to investigate and report on the financial activities of the corporation, specifically the benefit received by the two board members who live on the premises and whose living expenses are paid by the charity. Based on the report, we will determine necessary remedies. The second case is still in the early stages of investigation.

Another example is a San Antonio based "church", the founder of which allegedly uses church income to support certain private businesses. He has provided some information voluntarily and agreed to divest the church of the one business we could identify (it loses money for the church of course). Because this appears to be a classic inurement case, we have referred the case to the IRS.

We are also investigating a Dallas 501(c)(3) hospital which issued tax exempt bonds in 1989 and 1991. Allegedly, the doctor who runs the hospital has used bond funds to pay a construction company owned by his family. We are investigating the alleged conflicts of interest and self-dealing.

Q: What sanctions are available in cases where you have found inurement?

A: Because our enforcement actions are based in the common law, the range of sanctions is broad. Ordinarily, we remove (either by agreement or court action) the recipients of the inurement, reorganize the governance of the charity to prevent a repeat occurrence and secure an order for restitution. Usually, full restitution is impossible but sometimes we are able to secure the return of some funds. There is no statutory provision for fines or penalties unless the activity was one which can be prosecuted under our state's Deceptive Trade Practices Act. The Texas Attorney General does not have criminal jurisdiction over charitable trust matters. Therefore, in particularly egregious situations, we refer the case to the local criminal authority for prosecution.

Q: How can Federal law be improved to identify and sanction inurement?

A: The Internal Revenue Code should be revised to allow intermediate penalties such as fines, injunctive relief, removal of directors or officers so

that, as described previously, the IRS is not forced to choose between revocation or no penalty.

5. ADMINISTRATIVE MATTERS

Q: How has staffing changed in the last five years?

A: It has essentially remained the same. In 1988, the section's professional staff changed from four lawyers to three lawyers and two investigators, one of whom is a CPA. There are two full time secretaries and one clerk whose position was increased from part-time to full-time in 1992. In addition, the section uses two part-time law clerks.

Q: How much staff time is devoted to public charities and how much to other matters such as charitable trusts?

A: This is difficult to measure but during the last five years, probably 75% of our time has involved public charities, 5% private foundations and 20% non-charitable organizations for which the Charitable Trusts Section has some responsibility (i.e. police and veteran's organizations that solicit public contributions). Probably 90% of attorney time has been devoted to public charities

Q: Does your State review a tax-exempt organization to determine if it continues to meet its exempt purpose?

A: We do not do so on any routine basis, because we lack the necessary data. However, in the case of The Methodist Hospital, one of our claims was that the Hospital failed to carry out the purposes on which its state and local tax exemptions were based. The Hospital claimed, among other things, that the statutory requirements were only requirements for securing tax exempt status and that it had no duty to continue to act in accordance with those requirements. That specific issue was never resolved in the litigation but it is a frightening argument which may be raised again by other exempt organizations.

It is our understanding that most local taxing authorities do not review tax-exempt organizations to determine if they should remain tax exempt. Therefore, once an organization has obtained exempt status, unless some egregious problem is brought to the taxing authority's attention, the exemption remains.

Q: As the number of charities increases, what concerns are raised at the State level when the number of IRS exempt organization staff decreases?

A: There is a growing concern in Texas over the inability of Texas enforcement authorities and the public to obtain information about Texas charities and those soliciting in Texas. As the IRS exempt organization staff decreases, it grows ever more difficult to obtain what is supposed to be public information from the IRS or to expect IRS action on cases referred to the agency.

Q: How could Federal law be changed to improve the ability of States to administer and regulate public charities?

A: The most helpful change from a State regulatory view would be to allow the IRS to share information with state charities regulators. For example, the Food and Drug Administration is permitted to commission certain state officials to receive otherwise privileged information, with the federal confidentiality provisions preserved. Sharing of information would do much to advance the IRS/state cooperation which all parties have been actively pursuing for several years.

Also, Federal law should be changed to require that hospitals which are tax-exempt under Section 501(c)(3) must provide a reasonable amount of charity care as determined by the needs of their community, the benefits of their tax exempt status and the hospital's own resources.

We will be happy to provide any further information which the Subcommittee feels would be helpful or to answer any questions. Should you desire further information, please feel free to contact Assistant Attorney General, Rose Ann Reeser, Charitable Trusts Section at (512) 475-4181. Thank you once again for the opportunity to assist you in this endeavor.

Respectfully submitted,

DAN MORALES
ATTORNEY GENERAL

Chairman PICKLE. I am going to pick and choose some of these in the interest of time. One question was raised regarding public accountability. It says, "What is your State doing to give donors additional information about public charities in your State?"

His answer says, "Because Texas has no law which requires public charities to register with the State, the State has very little information about the specific public charities in Texas. This office, the Attorney General's Office, helped draft and support a bill in the most recent session of the Texas Legislature that would have required Texas charities to file a copy of their form 990 with the State so that basic financial information would be easily available to the public. This bill was opposed by certain religious organizations in the State and the bill did not pass." He goes on to say that the form 990 is a good form.

Then we raised the question, "Are there other sources of information and how accessible and helpful are they to the public?"

He made this statement: "According to the Internal Revenue Code, a charity's form 990 is available through the Internal Revenue Service. However, it has been our experience that in Texas it usually takes months for the IRS to respond to a request for a form 990, and on several occasions in the recent past, the IRS has been unable to locate a requested form. We are well aware of the lack of resources and personnel in the IRS exempt organization area and we do not mean to belittle the hard work of its employees, but this illustration is simply to point out that publicly available information is extremely limited in Texas."

He has indicated they can't get information for months and months and months and sometimes never get the information.

You can respond to me later, but I have passed this information on to Internal Revenue Service because this is shocking.

Now, it says, "What information can you provide about the standards and requirements and procedures of your State taxing authority for the grant, denial or revocation of a State tax exemption?"

His answer says, "The Texas Comptroller of Public Accounts grants exemptions from franchise and sales tax to organizations which have applied for such exemption on the basis that they are exempt from Federal taxation under section 501(c)(3) of the Internal Revenue Code."

Now my question or my consternation is that apparently once an organization applies for a 501(c)(3) status, that organization immediately can start receiving deductible contributions and expending them. A fundraising organization can take their slice and their share of the proceeds, and all you have to do is pretty much apply for a 501(c)(3) and immediately the presumption is that you are going to get it. You know in 99 out of 100 cases, they get it.

Now my question is, is that a good practice to leave that wide gate open because everybody goes ahead on the assumption, "Well, I am going to get it." We grant the exemption just by applying whether it is a perfectly good organization or not.

I am going to give some other examples: "What changes in Federal law or the form 990 and its instructions would improve the availability and quality of information to the public?"

His response is "Our office, that of the Texas attorney general, has worked closely with the IRS through the National Association of Attorneys General and the National Association of State Charity Officials to ensure that the form 990 provides useful and accurate information to the public."

This is your organization and my State. He works with your group. "Changes in the 1992 form 990 concerning the reporting of executive compensation by related entities and joint cost allocation are helpful in providing a more accurate picture of a charity's financial operation. It would be helpful, whether through changes in the law or simply through an increase in funding, if the IRS were required to and had the resources to respond more quickly and completely to requests for public information."

He just says again that he can't get any information out of them. And it is either they don't have it or they won't tell you or it is hard to cooperate.

Now, here is an example. We said, "Please identify what you believe to be abusive practices of public charities."

Here is an example: "The Board of Directors of the Children's Transplant Association, a Texas-based 501(c)(3), held funds in trust for the benefit of particular transplant patients whose families and communities had raised the money.

"One member of the board of directors and his wife, a paid staff person, controlled the funds and, according to a report of the court appointed receiver, during the course of the last 2 years, received over \$400,000 and it was used for other purposes.

"Now, the charity is in bankruptcy and the families who were relying on those funds have nothing. The remaining members of the board of directors apparently took no interest in how the organization was being operated or how the funds were being spent until most of the money was gone."

Another example: "A Dallas-based 501(c)(3), which under the guidance of its founder, who was also a board member and a salaried employee, spent inordinate amounts of money on lavish fund-raising events leaving nothing for charitable pursuits. In that case, some board members were paid for services rendered to the fund-raising event and some simply ignored the situation. When the activity of the founder and executive director were exposed by a local paper, the board members simply resigned." In other words, there wasn't any action against them. They just resigned.

That may have been in some of the examples submitted earlier, but I haven't even tried to pair them up yet.

We said, "On self-dealing, can you comment on that?" And I will read that "the founder of this organization and his companion are both salaried, although the salaries are very small. Furthermore, the founder claims he is entitled by board resolution a vote of himself and his previous companion to free room and board at the charity's facility. The charity pays all the living expenses, including car, groceries, weekly maid service, hair coloring, beer and cigarettes. There is no control at all over what they spend," and he goes on to talk about it.

I have one or two more cases. "In another current case, the three board members, consisting of a tax attorney, a CPA, and a third individual who rarely, if ever, participates in the operation of the

charity. This 501(c)(3) public charity is ostensibly raising an endowment to open a private high school. To date all contributions to the endowment have been donated as property, such as land and breeding stallions, by clients of the lawyers and the accountant.

"The IRS has issued private letter rulings that the endowment's holding of breeding stallions and a herd of cattle are related to the charitable purpose of the organization." I think it would help if a court would review that.

I will give you maybe one more. Here is a case where the Methodist hospital in Houston had said they didn't have to service the poor; said it had no duty under the law to serve poor people. A suit was brought against them and there has been something published about that. I think they recognize now that they do have an obligation to serve the poor, and the laws are being changed, and they are making considerable contributions back to the State.

Now, here is one last example. "Hiding behind church status to claim no responsibility for any public accountability or compliance with any regulatory requirement. Robert Tilton, a Dallas-based evangelist, has repeatedly refused to disclose financial records to the State of Texas on the grounds that all State statutes which require such disclosures impinge upon the separation of church and State, and violate the First Amendment rights to freedom of religion.

Despite the fact that his church was organized as a Texas non-profit corporation, received gross revenue of at least \$65 million in 1991, and that serious questions had been raised about whether money was used for any charitable purpose or for Tilton's own enrichment, a Federal district judge enjoined the State's investigative effort. "I don't know what this State would have done with that ruling there, but I am also about to find out. That ruling has been overturned by the Fifth Circuit Court of Appeals and Reverend Tilton has petitioned the U.S. Supreme Court for writ of certiorari and the State court proceeding is pending."

We have some other TV cases and so forth. Now those are some examples that my attorney general has given to us that are specifically in line with what is going on out there. He is saying that we need more information from the form 990, that when he tries to get more information, he can't get it from IRS, or it takes months and months. He specifically talked about the cases that are happening in his State where he is bringing suit and he is having a hard time making convictions out of them.

Are you having the same trouble?

Mr. ORMSTEDT. Yes. Our experiences are similar and I can say with complete confidence that the experiences of 48 other States are also similar.

With respect to 990 information, as my statement indicates, we receive a 990 as the basic financial statement for charities and therefore we have a great deal of interest in what it looks like. My problem, Mr. Chairman, is not so much with what the 990 requires now. In my opinion, it is a fairly good form. My problem is in how charities fill it out and how nobody is paying attention as to how charities are filling it out.

Let me give you a good example of what is going on. You were talking earlier about charities that receive and distribute commod-

ities as part of their charitable work. When the IRS was reviewing the form 990 with you, it was pointed out that the value of those commodities goes on line 22, which is grants and allocations. That line requires a schedule to be filed with the IRS and with the States showing where all these commodities went and so forth.

When we sued six major charities and Pennsylvania sued four of the same major charities for, in our opinion, misrepresentation with respect to the valuation of those commodities, what we immediately started seeing with the next round of filings, not necessarily from those same organizations, but from others who engage in similar transactions, was that instead of putting in the value of those commodities on line 22 where a schedule was required, now they are putting it in on line 23, which is called specific assistance to individuals.

It is not, but the beauty of it for the charities is that no schedule is required if you fill in that line so we can't tell where these commodities are going. And nobody is paying attention to that. The 990 form lacks integrity right now.

Chairman PICKLE. How do we cure that? How do we correct that?

Mr. ORMSTEDT. I think the States need to be vigilant in making sure that charities try to fill this out accurately, but the IRS also has to be vigilant and it has to be a dual effort.

Chairman PICKLE. Is the IRS vigilant in this area?

Mr. ORMSTEDT. In paying attention as to how 990s are filled out?

Chairman PICKLE. Yes.

Mr. ORMSTEDT. I would say they are not, but I would say that is probably due to just an inability to do it because of resources. But they are not, and charities know that.

Chairman PICKLE. The growth is alarming. We have said previously that there are over a million of these tax-exempt organizations and another 300,000 churches and the trend or the growth is becoming an alarming number.

We have 120,000 more in 1992 than we had 4 years previous to that. They are growing at about a rate of 30,000 each year. Now, the number of people they have in the EPEO organization today is less than it was the last year or 2. If it is not less, it is about the same. I think it is actually less. So, it means that we either don't care or the numbers are so big that we don't know how to handle it.

But the tax-exempt organizations, the charities know how to do it. They are actually forming them so fast, all they have to do is apply and, bingo, you are in business and that is a reprehensible. I think you have to have some kind of an exemption for emergency cases where applications are being filed. But I have a feeling one of the best things we could do is just say to the public, "No more 501(c)(3)s except in emergencies or in certain cases until we can get our house in order." This doesn't do anything about the million cases that are out there, but something ought to be done to correct this situation.

I don't know that it serves any good purpose to try to see where the error, the damage, or the weakness is, but we do know there are some changes that have to be made. I think one of the first things we could do would be in the area of the 990 form, but it is so complicated to interpret.

If you heard what Mr. Schoenfeld was explaining, you don't know whether he was coming in or out part I, II, III or IV, or what was the most important in his hypothetical cases, which was demonstrative but confusing.

This is no reference to his explanation. It is just the fact that it is like that.

I want to ask a specific question of you and the IRS, but first let me yield to Mr. Houghton.

Mr. HOUGHTON. Well thank you, Mr. Chairman. I won't take long. I am trying to sum up what has been said here, sum up the salient points, sum up what you do in the IRS and what we do here, what the Treasury does. It would seem to me that from what I heard today that clearly more light needs to be put in the system. There are a variety of different things.

One, clearly there has to be better information, more available information, as far as form 990 and 990 PF.

Also, I think that you, Mr. Ormstedt, mentioned the fact that we ought to change section 6104, which in effect is again more information, just sharing it with the States; is that right?

Mr. ORMSTEDT. That is correct.

Mr. HOUGHTON. So that is one sort of general category. If you have the information, then you can do what you want with it. You can put it up in a report and have it gather dust or you can activate it in some way. But unless the information is available in reasonable form so that you don't have to reconstitute it and make that available for both Federal and State, then you can't do anything.

It would seem to me that that is something that the IRS does without regard to the committee. I mean that is something the IRS and the Treasury Department can do.

Ms. Richardson could probably do that herself if she wanted to do that. Am I wrong?

Mr. SCHOENFELD. You are saying—I am sorry?

Mr. HOUGHTON. What I am saying is have adequate 990 forms, which really spell out the information. Have they been available to the proper authorities, including the State authorities?

Mr. SCHOENFELD. There are no doubts at all, Mr. Houghton, that there are weaknesses in our ability in collecting the form 990s, filing the form 990s, and making them available to the public. It is an area that we are looking into. It is an area that we are looking to improve.

Mr. HOUGHTON. I am sorry to cut in, because we have to go. At least you are aware of this.

Mr. SCHOENFELD. Oh, yes.

Mr. HOUGHTON. It is no secret, you are looking into it. Clearly you are going to bring something back to the Secretary of the Treasury and Ms. Richardson that is doable. The basic information sharing is able to massage the information.

Mr. SCHOENFELD. Yes.

Mr. HOUGHTON. OK. The other thing is really putting some bite in the system, having a deterrent effect. I know the independent sector has suggested a variety of different things such as intermediate sanctions like 5-percent excise tax. There are a variety of things that you have suggested.

Now, does that require legislation on our part or is this something which could be done through administrative action?

Mr. SCHOENFELD. That would without a doubt require legislation.

Mr. HOUGHTON. All right. Suppose we back off from the excise tax. Are there other things you can do to put some fire into this information once it is accumulated so that the people out there who are abusing the system are fearful that their 501(c)(3) status will be revoked?

Mr. SCHOENFELD. We think there are some options here and we think we have initiated some options. For example, we have initiated our coordinated examination program. It focuses on the largest organizations. We think—

Chairman PICKLE. What kind of program?

Mr. SCHOENFELD. The Coordinated Examination program where we take a look at the largest cases. We think that is the area that we should be putting the most attention on within our limited resources, that we think is an area that deserves IRS scrutiny and we are doing it. The agents and the case managers that you had here before are all part of that program.

Mr. HOUGHTON. If I could just continue, if that is all right for just a second?

Chairman PICKLE. Yes.

Mr. HOUGHTON. My impression is that the larger foundations, which really want to obey the law, would welcome something like that because they are being tarred by the same brush. Improvements might create an element of fear on the part of people who are going to abuse the system. Because as it is now, it is through a lack of resources or a variety of different things that there are tremendous abuses going on and they really aren't being picked up.

Another thing, it seems to me, it is very difficult if I set up a foundation. It is very difficult to understand what the standards are as far as inurement is concerned.

I think that you mentioned, Mr. Ormstedt, that it really has to be done on a case-by-case basis and others have mentioned this fact. That is really not good enough. If I set up a foundation and I wanted a very good person and that person puts his price tag on the line, I would want to know how it fits into the overall scheme of things.

I can do that if I am in business. I know if I have a \$10 million corporation versus a \$4 billion corporation, I know generally what is accepted. I don't know why that is impossible in the foundation field. I just wonder why it is impossible to give some general guidelines. Obviously abuses may occur over personal loans for a family vacation or clothes allowance or things like that, but the normal things such as salaries and expense accounts could be addressed.

There must be some general guidelines that can be set out in terms of magnitude or complexity for foundations.

Mr. SCHOENFELD. There is a problem here. The question is whether the Government should be setting the standard or whether the industry itself should be setting the standard. You referred to corporations, taxable corporations, and the rule as we testified on June 15 for purposes of determining what is reasonable compensation in the case of a public charity is the same rule that is

in place for determining what is reasonable compensation for purposes of deductions by a business corporation.

Those rules are found under section 162, like businesses similar in size, similar services. This is the standard there and there are industry groups within the charity area that do publish figures as to ranges of salary and they are a takeoff point for reference.

Mr. HOUGHTON. So, why the abuses then if it is just the same as it is in business?

Mr. SCHOENFELD. I think we have abuses in the exempt organizations area for a variety of reasons. I think that as we also testified on June 15, the sole sanction available to the Internal Revenue Service for misconduct is revocation of tax-exempt status. That might be applicable in an egregious case, one that is very much at the outside of the margins there, but where an organization is otherwise performing valuable services for the community as a whole or has innocent bond holders, has innocent employees, the revocation sanction threatens innocent persons.

Mr. HOUGHTON. There is just one other area, Mr. Chairman. It regards the terms of the specific details, who signs the form? Are there uniform forms that set out the little things which tend to create some sort of a discipline in the system which will tend to help in this process?

Thank you very much, Mr. Chairman.

Chairman PICKLE. Thank you, Mr. Houghton.

Mr. Brewster, do you have any questions for the panel?

Mr. BREWSTER. Yes, Mr. Chairman. I have some for Mr. Ormstedt as well as some for Mr. Owens.

We will start with Mr. Ormstedt. I didn't get to hear all of your testimony a moment ago. I went to vote and got captured over there on some other issues, but you reported that approximately 20 percent of the reports filed by charities of the State are returned to the charities for correction. What material aspects of the return are inaccurate?

Mr. ORMSTEDT. Our computer is set up to detect mathematical errors. If there are errors, an error so that the specific line is more than 5 percent off what it should be if it were added, or subtracted, or carried over correctly, the computer will kick that out and we identify that and that is one example of what we send back to the charity for correction.

But by and large, the mathematical errors don't reach that 5-percent level. What we send forms back most often for is because they don't fill out parts of the form that they were supposed to fill out. Most charities, not all, but most are supposed to fill out lines 13, 14, and 15. Well, many don't bother to fill that out and you can't tell what is spent for fundraising, and program, and management in general. Some organizations don't fill out parts of the expense statement. Many don't fill out the salary information because they don't want anybody to know that and if they send it to us, they know it is a public record.

Mr. BREWSTER. So it is a combination of things, but lack of filling out the blanks is the biggest problem and then mathematical errors would be somewhere behind that.

Mr. ORMSTEDT. Right.

Mr. BREWSTER. Has your State prosecuted any charity for willfully filing an inaccurate financial report?

Mr. ORMSTEDT. Yes.

Mr. BREWSTER. What were the circumstances and what was the outcome?

Mr. ORMSTEDT. There have been several. That is actually something we do on a rather routine basis. One I can recall that we just completed was underreporting of contributions. Much of the money was being paid to a professional fundraising firm. It was coming from the public to the charity's bank account and from the bank account to the professional fundraiser, but some of the money, not all of it, that was paid to the professional fundraiser wasn't being reported on the form at all. So it made look it like that the payments to the professional fundraiser were less than they were.

We had another case, it is not the most Earth-shattering case in the world, but somebody was underreporting their salary income and they didn't need to do it because the salary wasn't that big to begin with it.

Those were two recent examples.

Mr. BREWSTER. In your opinion, should the form 990 be changed specifically to show amounts for fringe benefits, severance pay, bonuses, et cetera?

Mr. ORMSTEDT. Yes. Right now, I don't believe that severance pay is reportable on there. I think—I will have to admit ignorance. I am not sure whether bonuses would be or not, but if it is not designed to pick up bonuses right now and severance pay, yes, I think it should be.

Mr. BREWSTER. A lot of these organizations are getting involved in political activities, pretty heavily, lobbying, et cetera. In your opinion, should an organization have to show on the form if they have assessed the excise taxes for political activity?

Mr. ORMSTEDT. Yes, they should be able to and I suppose that figure is on there someplace. I will tell you I don't know whether it has to be reported that way. I can tell you I have never seen one.

Mr. BREWSTER. Apparently it doesn't have to be at the moment. But if they have been assessed fines or taxes or those things, in your opinion should that have to be reported so their contributors would know what is done with the money?

Mr. ORMSTEDT. Yes, I think it should be.

Mr. BREWSTER. OK.

You have already said you feel like it should be changed to better identify the contract with fundraising and in-kind contributors.

Mr. ORMSTEDT. Yes.

Mr. BREWSTER. Thank you.

A few questions for the IRS guys. You have coordinated examination case issues here in your book, and by the way, it is a very interesting book. I find it quite thought provoking, but exhibit A outlines the issues in charity cases currently under examination by IRS. You list, inurements, private benefit, nonexempt activities, et cetera.

Are there other abuses that this Congress should be concerned about that may not have made the list yet, but something on the radar screen that we should be thinking about?

Mr. OWENS. Well, I think there is one rather large category that is not specifically enumerated there and that concerns tax-exempt bond financing where, in particular, where the charity is the recipient of funds. We have one of our special emphasis examination programs this fiscal year focusing on tax-exempt bond financing and we have about 27 cases underway where there are questions about the use of the bond financing proceeds and whether the organizations have been in compliance with the array of limitations and rules for financing.

Indeed it is a subsidiary issue in a number of the coordinated examination cases, the larger audits that are underway, some of which we talked about earlier today.

There are some rather significant questions relating to the bond financing.

Chairman PICKLE. Mr. Brewster, will you yield?

Mr. BREWSTER. Yes.

Chairman PICKLE. Will you give us an example of any one of these companies, any one of these practices where the tax-exempt bonds are being abused? Give us just an example of what is happening?

Mr. BREWSTER. Can you do that or do you have any that far along?

Mr. OWENS. Let me see if I can come up with an example.

Chairman PICKLE. The type of cases and how they are doing.

Mr. OWENS. There is a limitation on the use of bond proceeds that prohibits private business use above certain levels and what we have found is a fair degree of incidence of private business use in our audits. The audits are not a random sample of the universe; it is not a statistically valid sample. It represents cases, concerns we have had in the hopper for a while, but what we have found are organizations that will on occasion raise money through tax-exempt bond financing and then construct a building that is used in a private business use.

It may be, for example, a university has a bookstore and it issues bonds to build the bookstore and then sublets the bookstore to a for-profit book company to operate. Depending on how that arrangement is structured, you might have a private business use that would disqualify the bond—the interest on the bond from exclusion from the income of the bond holders. Similarly a hospital could use tax-exempt bond proceeds to build a medical office building next door.

The offices in the building could be leased to physicians for their private practice of medicine. That would qualify as a private business use, potentially jeopardizing the bond itself, the tax-exempt feature of the bond. The difficulty we have here is not unlike the problem we face with a charity, a very large charity, maybe assets in the billion dollar range, but where someone is becoming very wealthy because of their position in the organization. They may be receiving a salary of \$1 million a year, an extraordinary salary under almost any measure. The only enforcement tool is the tool of revocation of exemption.

With the bond issue, if the bond issue loses its exempt feature, the bite falls on the bond holder who in all likelihood is an innocent party to the entire deal. They may have bought the bond through

a broker and had very little idea of the actual use made of the proceeds, but they are the ones who pay the penalty because suddenly they have income that is now taxable when the bond loses its exempt status.

So I think there are some real concerns there with the nature of the tax-exempt bonds.

Mr. BREWSTER. Traditionally tax-exempt bonds have principally been governmental entities, counties, cities, water districts, et cetera. Are you having a lot of these issues being done by charities or is it principally university-type status?

Mr. OWENS. Well, we have only just recently begun taking a more focused look at tax-exempt bond financing issues. I mentioned that this fiscal year we have had a special interest program on tax-exempt financing where a charity is the recipient of the funds. This summer, audit responsibility for the larger universe of municipal bond issues was transferred to the employee plans and exempt organizations function with the clear direction from Commissioner Richardson that we develop a focused, measured program to deal with perceived problems in the area. We are proceeding to do that this summer and this fall, to design an emphasis program in that area.

Mr. BREWSTER. But if the IRS reviews tax-exempt bonds and finds that they don't meet the status, revokes their tax-exempt standing, then the purchaser of that bond is the one who is out. The issuer has no liability whatsoever.

Mr. OWENS. Indeed.

In fact, we are in Tax Court now in a case called *Keith v. Commissioner* where the Service did indeed revoke the exempt status of the bond. The nature of the case is that Mr. and Mrs. Keith have now been assessed additional income tax and they are disputing that in court, but that is indeed how it played out in that case.

Mr. BREWSTER. OK.

On exhibit B in your book, you have 20 revocation cases and the reasons are unreasonable compensation, unreasonable fringe benefit, et cetera.

Specifically, what activities did the organizations engage in that resulted in the revocation and what is unreasonable compensation? On what basis do you look at the size of the charity or a percentage of their total income? How do you determine that?

Mr. OWENS. Well, in short, all of those things plus about a dozen more.

Mr. BREWSTER. It is one of those things that I will recognize when I see it, but I can't define it?

Mr. OWENS. Unfortunately analyzing compensation for reasonability is an art, not a science. We have a list that I think is well over 20 factors long that we have used in our continuing professional education materials for our revenue agents that discusses the wide variety of factors that we would look at. One thing that we would analyze would indeed be the size of the organization, how big a job is it to manage the entity.

The qualifications of the individual who does the managing, what is their background, what was their prior salary history? We would look to the specific responsibilities of the position, are they on call 24 hours a day or is this a part-time job, that sort of thing.

There are a host of factors, some of which are drawn from section 162 dealing with ordinary, necessary business expenses. There is a very similar question that arises with for-profits, with proprietary corporations, and in regard to the amount that is appropriate as a business expense deduction and what really is a dividend, a distribution of profits. So it is——

Mr. BREWSTER. Certainly some of the things we heard today are very easily in my mind determined to be abuses, such as personal expenses paid for by organizations, et cetera. What about purchases or sales between the organization and officers and directors? It is very strict in Government.

In most entities about purchasing from officers or directors, do the 501(c)(3), et cetera, do the charities have any legal requirements as a prohibition of that?

Mr. OWENS. Well, I would say that that would qualify as a suspect transaction in a public charity context. It is the kind of transaction we would ask the revenue agents to look at very closely and our focus would be on the extent to which the charity received fair market value.

If indeed it got something that was worth what it paid for it, or perhaps it got more than what it paid, it could have been a bargain transaction, then under present law, it would not jeopardize exempt status or trigger any other sorts of taxes.

Mr. BREWSTER. In your exhibit B, you list——

Chairman PICKLE. Mr. Brewster, would you yield?

Mr. BREWSTER. Yes, sir.

Chairman PICKLE. Mr. Ormstedt needs to catch a plane and needs to leave. Mr. Hancock has a question of him. Would you yield to Mr. Hancock?

Mr. BREWSTER. Absolutely. We certainly don't want him to miss his plane. I have missed a few at National. I know what that is all about.

Chairman PICKLE. Thank you for yielding and I will come back to you.

Mr. HANCOCK. Thank you for yielding.

Just a couple of questions. I notice in your statement you say that the exemption covers religious organizations, educational institutions, hospitals, and government instrumentalities. You have exempted about 75 percent of the charitable organizations when you exempt those. We have already heard enough testimony today. Perhaps religious organizations, educational institutions, hospitals, and maybe government instrumentalities are the worst abusers. I wonder if we are not exempting the wrong organizations here? Would you make a comment on it?

Mr. ORMSTEDT. My only comment is the nature of the political process back home. Hospitals managed to get themselves exempt from the statute as did educational institutions. You are right that religious organizations make up about half of all charities.

Mr. HANCOCK. Could I ask another question and this is how many—let's just say hospitals. You know practically every hospital will have a public restaurant in it. Do you have sales tax law in Connecticut?

Mr. ORMSTEDT. Do I have what?

Mr. HANCOCK. Sales tax in Connecticut.

Mr. ORMSTEDT. Yes.

Mr. HANCOCK. Do any of these hospitals collect sales taxes on their public restaurant?

Mr. ORMSTEDT. They don't collect sales tax.

Mr. HANCOCK. Is there a reason they shouldn't? I wonder how much revenue the States lose as a result of charitable organizations being in retail sales? A restaurant is a retail business. You know, they try to make a profit out of it.

Mr. ORMSTEDT. Well, if you get IRS-exempt status, then certainly in Connecticut all other exemption flows therefrom. Property taxes, sales, income tax. It is the ticket to riches. You could make an argument that some have made that commercial nonprofits, for example, hospitals and maybe educational institutions, should pay sales taxes.

Mr. HANCOCK. All they do is collect it.

Mr. ORMSTEDT. Pardon?

Mr. HANCOCK. All they have to do is collect it and not pay it.

Mr. ORMSTEDT. They do not now.

Mr. HANCOCK. It would be interesting to know how much State revenue is lost as a result of charitable organizations being in the retail business. You know you buy a candy bar at the hospital gift shop and you pay 50 cents for it. You go across the street to the drugstore and you pay 50 cents plus the sales tax. I don't know if that really is fair to the retail business consumers. So anyway I was just curious.

You would think if they were set up under the law, they ought to be willing to support the government a little bit, too.

Thank you, Mr. Chairman.

Chairman PICKLE. Thank you.

Mr. HANCOCK. Thank you for yielding.

Mr. BREWSTER. I would like to tell my friend Mr. Hancock from my time in the State Legislature anyone tough enough to get an exemption probably was tough enough to keep it. When you start dealing with those entities, tax exemptions become very interesting.

We appreciate your testimony, Mr. Ormstedt. If you need to catch a plane, head out.

Mr. ORMSTEDT. Thank you.

Mr. BREWSTER. As far as continuation of the other questions, I noticed you had revoked 3 of the 20 cases because of unreasonable compensation. The question I asked a moment ago—it is difficult to tell what is unreasonable. In these three cases, what is unreasonable?

Mr. OWENS. Well, unfortunately, Mr. Brewster, that same disclosure or privacy rule that—

Mr. BREWSTER. They are not complete yet.

Mr. OWENS [continuing]. That has haunted us all day, applies to revoked organizations as well as those audits in process.

Mr. BREWSTER. Very good. I didn't realize that or I wouldn't have asked the question.

Mr. OWENS. Of the 20 entities that are listed there, one has challenged the IRS action in Tax Court. That is a case called Anclote Psychiatric Center. It involves revocation of tax exemption of a hospital based on—in the Government's view—inurement of income.

Mr. BREWSTER. For the three, you have revoked their status because of inordinate compensation. They have lowered that compensation to regain that status.

Mr. OWENS. I am not aware that any of the 20 have reestablished tax-exempt status. I do not believe any of them have.

Mr. BREWSTER. If an organization loses its tax-exempt status or has fines assessed against it or whatever, is there any way the public knows that?

Mr. OWENS. If the organization simply pays the fine or the individual involved pays the income tax and does not challenge the IRS action in Court, there would be virtually no way for the public to ascertain that the IRS did indeed revoke exemption.

Mr. BREWSTER. So the public wouldn't know then if an organization lost its tax exemption because of illegal lobbying activity or if they were engaged in illegal use of assets between the directors and officers or anything like that?

Mr. BREWSTER. There is no way that the public would know those things?

Mr. OWENS. There would be no way that the public could reasonably find out. The only disclosure that is made if the Service takes adverse action is that there is an official delisting from the list of organizations to which contributions are deductible and that is published in the Internal Revenue bulletin. It is a very small publication and the bulletin itself is not the most widely read publication. So practically speaking for the average donor, it is very difficult to determine if an organization has lost its exempt status and it is impossible to learn why.

Mr. BREWSTER. So I could have been contributing to a tax-exempt charity for years, it loses tax-exempt status, and they just become a taxable entity and we would never know the difference, right?

Mr. OWENS. It would be difficult to ascertain that.

Mr. BREWSTER. OK. Something else: In the testimony a moment ago, we talked about in-kind contributions such as agricultural supplies, seeds, some of those things. I get concerned about the in-kind contributions and the value also established on many of those.

In the end, is there any charitable purpose served by those transactions?

Mr. OWENS. Well—

Mr. SCHOENFELD. We are waiting for our agents to tell us.

Mr. OWENS. That is indeed one of the questions we are exploring in those cases. What was the ultimate use made of the assets?

Mr. BREWSTER. Are there certain kinds of in-kind contribution that should not be allowed? For instance, outdated materials, whether it be food supplies or whatever, that are outdated pharmaceutical products that have exceeded life expectancy or outdated medical equipment that certainly would have exceeded certain life expectancy?

Should those not be allowed?

Mr. OWENS. Maybe the more important question is not whether they should be allowed or not, but how they should be valued. In other words, outdated medical equipment may still have considerable value to a hospital that doesn't have that outdated machine. Certainly a more modern machine might be more desirable, but

something is better than nothing. So the valuation question I think is a very important component of that transaction.

Mr. BREWSTER. But 10 bottles of doxycycline that went out of date in 1991, would they still be allowed the valuation?

Mr. OWENS. Something like that may have no value and consequently would—

Mr. BREWSTER. What other types of property have been involved in cases involving in-kind contributions other than, say, agricultural, seeds and products or medical equipment?

Mr. OWENS. Well, we have had a variety of situations involving clothing, books, the agricultural supplies. I don't have a complete catalog of the variety of in-kind contributions. Not all of them, of course, are suspect, but we have seen a fair variety of different kinds of materials.

Mr. BREWSTER. Thank you.

I have certainly enjoyed your testimony today. I can tell you that it is fairly obvious to me that there are a very small number of charities out there, religious and otherwise, creating a lot of problems for the thousands and thousands of very good organizations and I know it is very difficult for you to determine which ones are doing a really good job for charitable interests and which ones are out there simply ripping the system off.

Whatever we can do to increase your activity and productivity in determining which ones are in the fringe, I certainly want to help with and would appreciate any comments you have as we go along.

Chairman PICKLE. Let me ask a couple of questions. I know this is going on, but, Mr. Owens, you said that one category of abuse that you are looking at more closely these days now is tax-exempt—the issue of tax-exempt bonds, and that questionable practice is growing. Are you are being very vigilant about that?

Have you revoked the exemption of any of these charities on the basis of the bonds issued, the violation of the tax-exempt bond statutes?

Mr. OWENS. We have not to date. As I indicated, we began the special emphasis examination program dealing with bonds this fiscal year. We do have a number of cases in process where there are bond issues and some of those the bond proceeds were involved in private benefit or inurement transactions.

Chairman PICKLE. I guess I misunderstood you. I thought you indicated that you were really concentrating on that. But you have had no revocation of any charity on the tax-exempt bonds issue. You were expressing a concern or sympathy for the bond holders because they would be left with the bag. They haven't been left with anything yet because you haven't revoked anybody. They haven't been hurt. They will be the last to be hurt. The broker leaves the impression that they just are going to issue bonds and they are just trying to help the charity.

I haven't found any bonds salesman yet that wouldn't sell anything, including coffins for their mother almost, if they thought they could sell bonds out of it. I personally don't think I expect much sympathy for the bond sellers, but at any rate you haven't made any convictions yet.

You are just looking at it more closely and I am glad to hear you. I hope you pursue that much more closely.

Now, I want to ask a specific question here. We all agreed there is a possibility we might be able to establish some kind of a sanction, interim sanction, whether it is on excise tax of 5 or 10 percent, or something else in lieu of revocation of a tax exemption.

Mr. Owens, do you all think that is a possibility that we could look at? Would you favor that or can you deny an opinion on it? Are you authorized to say anything?

Mr. SCHOENFELD. I think that the purpose of our being here is to try to describe to you the difficult administrative and enforcement problems that we have. We have described to you the ineffectiveness of the sole sanction of revocation.

Where we go from there, Mr. Pickle, is something we are just not prepared at this time to get into.

Chairman PICKLE. Well, I will answer for you, then. The answer would be yes because we have got to find some other alternative approach to this thing.

How would IRS feel if this committee could attempt to establish certain guidelines for compensation?

Mr. SCHOENFELD. Are you referring to statutory guidelines?

Chairman PICKLE. Yes, not specific sums, but when is a charity eligible to pay a CEO \$100,000, \$500,000, or \$1 million? Could we dare, can you give us any suggestions on what kind of guidelines we might attempt to establish on that?

Mr. SCHOENFELD. Beyond suggesting that I believe it would be in your congressional prerogative to do something like that, I would be—

Chairman PICKLE. Mr. Schoenfeld.

Mr. SCHOENFELD [continuing]. Open to any suggestion.

Chairman PICKLE. Mr. Schoenfeld, I know it would be in my prerogative. Could you give us any suggestions? What about your prerogative?

Mr. SCHOENFELD. I think that as far as finding, it is a very fact-intensive issue. It is the kind of issue we send individual revenue agents out, on individual cases to determine. I don't think that we have the data on which to support any conclusions about broad classes of reasonable compensation.

Chairman PICKLE. Mr. Owens, I am not going to get any information out of Mr. Schoenfeld. If you would dare to venture any different opinion as we go along here, I would be glad to hear from you. What do you think about providing IRS with the authority in certain cases to grant tax exemption for a limited period of time such as 3, 5, and 10 years? Then, particularly if IRS has found out that there was noncompliance with the laws, you just give them a temporary license. Would that be of any help to you?

Mr. SCHOENFELD. There is a question of resources there and we have enough trouble keeping up with our existing workload. If we were obligated to take a look at a second type of new organization also after a certain period of time, it would really strap us, Mr. Pickle.

Chairman PICKLE. All right.

Suppose you had a situation where we might require the IRS to change form 990 to provide the public and the IRS with more information about their activities, such as when the organization has violated the law and paid penalties or taxes to the IRS for self-

dealing or prohibited political activities or excessive lobbying. Mr. Brewster asked the same type of question.

Mr. SCHOENFELD. There could be a public interest in that. Right now, the policy decision in the tax laws is not to make that information public. The returns that we receive that have the payments with respect to any lobbying or any political taxes that are owing are not public returns and there could very well be a justifiable public interest in knowing that a charity is spending money for taxes for violation of the restrictions on lobbying or political activity.

Chairman PICKLE. Well, what do you think about requiring the form 990 to more clearly identify fringe benefits paid to the executives, transaction between related parties and fundraising costs?

Mr. SCHOENFELD. This is something that we are working on, Mr. Pickle. The draft that we gave to you does try to deal with improvements in that area. We hope that the States will give us input into this.

If the subcommittee, yourself, have any suggestions, we would like to work on it. It is an area that needs attention.

Chairman PICKLE. Suppose you would put another proviso in that said that additional public access to the form 990 is required and that the organization mail the 990 form upon request?

Mr. SCHOENFELD. I personally happen to think that there is a lot of merit to something like that. Right now an organization may require the person to show up in person. It would seem to be a small thing to ask the organization to mail off a copy.

There might be a need for a small shipping and handling charge. If it were modest, I would think that would be an improvement on public accessibility.

Chairman PICKLE. We looked at some of the cases revoked last year, something like 27 cases. Of that 27 cases, if my facts are correct, about 11 of them are based on inurement.

In other words, nearly half of the cases involved were pertaining to inurement.

Now, in all those cases, none involved actual hospitals or universities. It would appear to me that the IRS is unwilling to punish a charity on the basis of inurement because the only available sanction is revocation of the tax-exempt status.

Mr. SCHOENFELD. We have testified as to the dilemma that faces the Internal Revenue Service, the difficulty, because of the nature of the revocation sanction, and the fact that it does often punish innocent persons and let the culpable ones go away scot-free.

Chairman PICKLE. I am going to make a general statement here, because I am trying to find an answer and each time we make some kind of proposal, there is always a reservation, a hesitation, or what I view as alarm.

All day we have tried to get some cases out before us so that the public would understand who is actually violating or abusing the charity laws. We haven't gotten much public information except in general. The answer is that this is not just the religious groups. We have been restricted from revealing the names of the organizations. I wonder out loud what are we really gaining by being so super careful not to infringe on the legal rights of a pending case or of an organization up for examination?

All day we have refused to say this about company A, B and C because it might affect a pending case. Now, with over 1 million cases, you had 27 revocations last year. Nearly half of them involved inurement. I don't see much activity. I don't see much pursuit to find an answer.

I ask myself sometimes, suppose I did bring out all these names, what have we lost? You are not going to sue them anyway. You are not going to convict them anyway. If I did bring out information today that you say might hurt a pending case. I ask myself, I don't believe IRS is going to pursue any cases to begin with, at least that is very unlikely. The point is that with all this tremendous growth of these organizations, we are not doing anything bold to stop them.

You are getting fewer people to work in the field and yet you want to protect the legal rights, and not foul up a case that is pending. Nobody wants to do that. But sometimes I get to thinking let's go ahead and mention names and jump into this thing hard. At least maybe we might get some action. I don't think we are going to find any kind of an answer to this problem unless the IRS jumps in with both feet and unless IRS forms a better alliance with the State organizations so that the States can do something on it, one or the other, or both, where we are not active enough.

Nobody in the Congress wants to hurt a charity that is performing worthwhile services. They do a much better job than Congress or the Government could ever do. But the trend of violation is growing in an enormous amount. You heard a State attorney general say this afternoon that it is, while he didn't use the word smothering, he said the horses are around and they are trampling down all the crops in the field. It is that big of a growing problem. It would seem to me like charities are being created for the purpose of giving some people a lifelong stipend to serve as an executive director or CEO of an organization.

It is kind of the in thing to do now and there is no way to get at it.

Now, those are not statements that I charge you with, but those are reactions that some of us have. What are we going to do about it? Now, we have this testimony today that has been helpful because at least we did pinpoint the types of cases and what is out there. It is my hope that this committee can produce something that would be substantive and would be correctional with some sanctions, or some other kind of penalties.

I even think criminal penalties, because unless we do something, we are going to be overwhelmed with it.

So I am not making any big statements, but I am expressing sort of the chagrin and the disappointment and the frustration that many of us feel. If we feel it, you must feel it even more acutely because of the enormous task that you have with such a limited force. But we have got to find a better answer and that is why we are holding these hearings. I hope that we produce something that is worthwhile. We could have gotten headlines today about organization one, two, three, four and give their names and their names would be on the headlines, but we still wouldn't correct the problem we are trying to correct.

So, if you have got any suggestions down the street about how we can go at this problem, we would like to have them. And if you don't have them, we are going to try to produce something and say: You live with it. Simply, we think we have to do a better job in the whole field, and I know you agree with that.

We need to do something, and if we do it right, it is about working together. Now, let's do that.

Now, I know it has been a long hearing. Well, they said we have asked enough, so we will stop at this point. We will be having some additional hearings, perhaps with some names involved where we can actually bring them out. We hope we can produce something worthwhile a little bit later.

We must stop the abuses, if for nothing else other than to protect the good foundations, the good charities that are really doing a great job for America. That is going to be our goal.

Well, we thank you very much for the testimony today. Thank you all. The subcommittee will stand adjourned.

[Whereupon, at 6 p.m., the hearings were adjourned.]

[Submissions for the record follow:]



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Daniel Geoly
President

August 23, 1993

Chairman Pickle and
Members of the Committee on Ways and Means,
Subcommittee on Oversight:

We applaud your current efforts to address the difficult issues confronting the Committee regarding the administration of and compliance with the laws applicable to tax-exempt public charities. We appreciate the opportunity to present our views and personal experiences which exemplify certain abuses of these laws and which may be of assistance to you in your investigation.

Our purpose in submitting this statement is to point out abuses of the public trust and tax exempt guidelines by public charities in addition to those involving inurement and private benefit. Our written comments focus on: (i) the lack of accountability to federal, state and city granting agencies as well as public contributors for the commercial use of their public grants and contributions; and (ii) the lack of enforcement of the tax laws for non-profit performing arts groups which engage in certain commercial activities. These activities are rising to a level such that our business is threatened and we are powerless to do anything about it. We would like to make clear that our comments are not a complaint of general increased competition, but rather, of the lack of a fair playing field on which we can compete with these organizations. As members of the tax-paying business community, it is our hope that a discussion of our problems with the agencies responsible for oversight and funding of these non-profit organization's activities may assist the Committee in its endeavor.

SUMMARY

We first wish to state that non-profit performing arts groups perform a valuable service to the public by bringing art to the public that would not be provided but for such organizations. However, in the current times of budget cuts, reduced public contributions and grant cutbacks, such groups have become overly aggressive in their pursuit of necessary funding, often by entering into for-profit commercial ventures. With the usage of American taxpayer dollars, these organizations receive federal, state and private funding, exemption from federal, state and local income, sales and property taxes, federal unemployment taxes as well as contributions of property. Thus, once these non-profit

organizations start competing in the commercial arena, unfettered and armed with such subsidies, businesses such as ours face extinction.

We have encountered the following difficulties in our attempts to investigate this growing competition:

(1) Even after numerous efforts, we have been unable to obtain copies of the competing non-profit organizations' annual 990 Forms from the Internal Revenue Service (out of requests for 5 such organizations only 1 was obtained 4 months after the original request).

(2) We have been unable to obtain copies of the competing non-profit organizations' exemption applications (Form 1023) and exemption letters from the Internal Revenue Service (out of requests for 5 such organizations none were obtained).

(3) In response to our inquiries with the federal and various state grant organizations regarding whether the grant guidelines prohibited the use of grant monies for commercial endeavors, we were informed that as long as the individual organization maintained its federal tax exemption status, it did not matter that such funds might be used for commercial activity.

(4) We have been informed that Form 990-T which is used to report income and expenses from an unrelated trade or business of a non-profit organization is not available for public inspection.

(5) We have learned that there is no formal Internal Revenue Service procedure for reporting suspected violations of not reporting and paying tax on unrelated business income.

(6) We have been informed that even in the case when an informal report is made of suspected violations, there is no disclosure of the outcome of an investigation, if any, under the public's freedom of information rules.

In response to these problems, we respectfully recommend the following:

(1) Improve public access to all non-profit organizations' Form 990, Form 1023 and exemption letter by requiring each public charity to provide a copy of these documents to the public upon written request within 30 days from receiving the request. The charity will be allowed to charge a nominal fee to cover its copy and mailing costs.

(2) Require any non-profit organization receiving a grant in excess of \$10,000 per year from any federal, state or local funded grant organization to provide copies of its Form 990 to that agency.

(3) Organize an independent review board to review complaints from the public regarding suspect activities of non-profit organizations. The board would be authorized to recommend that the Internal Revenue Service undertake investigation of these suspect activities. The board would also monitor the progress and ultimate outcome of such investigations. (As more fully discussed in the section titled "Recommendations").

(4) Provide for some form of penalty, short of revocation of exempt status, for abuses of the tax laws by exempt organizations. Penalties similar to the excise taxes applicable to private foundations, if applicable to public charities, would provide the Internal Revenue Service some means of redress for abuses by public charities.

(5) Revise Form 990 to reflect some of the information contained on the 990-T (which is not presently available for public inspection), particularly expenses allocated to any unrelated trade or business and a more detailed discussion of the commercial activities. This would provide information to contributors as to whether their contributions are supporting any commercial business.

(6) Revise Form 990-T to account for subsidies, if any, that were received by a nonprofit and used to carry on an unrelated trade or business. At present, Form 990-T makes no adjustment for general operating expenses which are funded, for example, through grants for general operating support. Thus, there is lower income amount subject to tax even though many of these expenses are paid for by tax deductible contributions.

(7) Require a specific allocation of charitable contributions made by a non-profit organization between its exempt income reported on Form 990 and taxable income reported on Form 990-T. At present, all charitable contributions made by a non-profit organization may be allocated to taxable income resulting in a lower income amount subject to tax.

DISCUSSION

Background

Eaves-Brooks manufactures and rents theatrical costumes and uniforms. The original site of Eaves Costume Company was a modest West 12th Street costume shop in lower Manhattan, then the heart of the theatre district. It opened for business in 1863, the year Lincoln delivered his Gettysburg Address. Founded by Albert G. Eaves, subsequently purchased by Charles Geoly in 1910, it continues for three generations as a wholly-owned family enterprise.

In its early decades, Eaves supplied costumes to New York's flourishing opera and Shakespearean stock companies, minstrel shows, vaudeville and burlesque, then the mainstay of American theatre. As the theatre area moved uptown, so did Eaves, first to lower Seventh Avenue, then to West 46th Street, and later to West 55th Street. From those facilities the firm supplied quality wardrobe for Broadway and touring plays, operas, operettas, musical, education, community, summer theatre, and silent films produced at New York and New Jersey motion picture studios. With the resurgence of film production in New York and throughout the United States, we have and continue to costume major motion pictures.

By the mid 1920's and throughout the 1930's Eaves' expanding inventory increasingly served the nation's proliferating community, university, college high school and summer theatres. With the inception of television, Eaves became a prime resource for that new entertainment medium.

New York was the birthplace of live national television and Eaves was the prime costume resource for such prime productions as THE MILTON BERLE SHOW, PLAYHOUSE 90, YOU ARE THERE, YOUR SHOW OF SHOWS, THE PERRY COMO SHOW, HALLMARK'S HALL OF FAME, CAPTAIN KANGAROO, and OMNIBUS. More recent TV credits include THE ADAMS CHRONICLES and ROOTS, and such present shows as SESAME STREET and SATURDAY NIGHT LIVE. Throughout more than four decades, this pioneering and ongoing work for the television industry has increased Eaves-Brooks rental inventory by more than 300,000 costumes. We are also privileged to manufacture the lavish costuming for annual editions of RINGLING BROTHERS BARNUM & BAILEY CIRCUS, DISNEY ICE SHOWS and numerous glittering casino extravaganzas.

With the assistance of New York State and New York City Agencies in 1981, Eaves-Brooks acquired Brooks-Van Horn Costume Company and subsequently relocated to our present 100,000 sq. ft. six story Long Island City headquarters, adjacent to the Astoria and Silvercup film and television studios, just 10 minutes from Times Square. Thus, we were able not only to maintain our labor force, but were able to increase it as well by some 30% over the last 12 years. After 125 years and three generations, we are pleased to be of continuing service to all areas of America's entertainment industry and take pride in the fact that there is hardly a night in the year on which a show with "Costumes by Eaves-Brooks" isn't playing somewhere throughout our country. That's an opportunity and responsibility we will always cherish.

Eaves-Brooks has actively supported non-profit theatre and opera. We have always strived to keep the costume rental cost to these valuable organizations at the bare minimum. During this 100 year existence, Eaves-Brooks has established one million professional costumes by utilizing its own resources. These professional costumes after use by Broadway theatre, motion picture, and television then become available to non-profit theatre, i.e. educational theatre, community theatre, summer theatre, regional theatre and opera, at reduced rates in many instances 50% less than professional companies would have to pay. It's very possible that on a given evening, the original dress that Julie Andrews wore in MY FAIR LADY may be in a high school production being worn by some young lady in the Mid West.

Within the past 10 years certain non-profit theatre and opera groups after receiving grants and charitable contributions, utilized American taxpayer dollars in the manufacture and purchase of theatrical costumes for their own use. Thereafter, when the production had terminated, these costumes were rented directly to other non-profit and for-profit theatre groups. During this period, the market share of this inter non-profit costume rental business dramatically increased. This has caused us a severe hardship due to the fact that many of these non-profit theatre groups are our customers, and we could not compete at rates that were substantially lower than ours because these competing organizations were totally subsidized.

This past Spring, the competition from costume rental by non-profit organizations has reached a point whereby Eaves-Brooks existence is threatened. These non-profit organizations are actively bidding for costume rentals to both for-profit and non-profit entities and are undercutting market prices for costume rentals by up to 80%. Currently, these non-profit organizations are

renting costumes for entire productions rather than on a piece-to-piece basis. Some of these competing organizations have received costume donations of complete productions of Broadway plays.

In addition to the fact that non-profit community theatres are re-renting these subsidized wardrobe after their own usage, a second but even more serious occurrence has been established, namely, that there is now in existence a totally subsidized, non-profit, full-time operating costume company, which is competing with us directly at rates some 50% to 80% less than ours. In fact, this organization's costume inventory has been publicly stated to amount to over 75,000 costumes which they have obtained through charitable contribution donations and subsidized grants. It is our understanding that this non-profit costume company is able to pay substantially higher wages and more generous fringes and medical benefits than we could possibly afford because they are totally subsidized.

As a businessman, I am sure that you can understand our frustration in this matter when the fact is that, in part, our own tax dollars, as well as other American tax dollars, are being utilized to subsidize a form of competition that is totally unfair and which could result in the termination of our century-old business.

Eaves-Brooks' Investigative Efforts

For the past two years we have been actively investigating what avenues are available to us to deter these perceived commercial abuses by certain non-profit theatre and opera organizations. Our efforts, however, have proved fruitless. As a result, absent our comments to this Committee and an informal complaint to the Internal Revenue Service, we are powerless to do anything.

We have contacted the National Endowment for the Arts (which is federally funded) and the various State Arts Councils (which are state funded) (hereinafter "Arts Councils") and obtained final reports for many grants made by those organizations to the competing non-profit theatre groups. From this information we have determined that grants were provided to fund complete theatre productions including the cost of designing and manufacturing costumes. We have also noted that grants were made for "General Operating Support" and, in one instance, amounted to \$100,000 per year.

We have made many inquiries with the Arts Councils asking whether they monitor or regulate the non-profit theatre's use of costumes manufactured with grant monies after the completion of the specific theatre productions. In particular, we have asked if the Arts Councils were concerned that these costumes were later rented to for-profit organizations to the disadvantage of companies such as Eaves-Brooks. We were surprised to learn how little supervision is exercised by these Arts Councils over grant monies given to non-profit organizations. One response stated the following:

"Due to severe cut-backs in grants and aid to arts and cultural organizations, the federal, as well as many state and local governments, have been encouraging non-profit organizations to seek alternative revenue sources. Many organizations have taken an active role

in this challenge through earned income activities within non-profit exemption guidelines. We do not believe in this environment that non-profit organizations should be penalized for their efforts in this regard." (emphasis added)

The Arts Councils similarly responded that once federal exempt status is achieved, in the words of one director, "[w]e may review and confirm such status but have no role in questioning whether such non-profit status, once duly granted, should be questioned on either a factual or policy basis."

We then sought to determine whether the competing non-profit organizations were acting within their non-profit exemption guidelines. To achieve this, we needed their respective Forms 1023, Application for Recognition of Exemption, which would state exactly what charitable activities formed the basis for their tax exemption. In addition, we needed to obtain their respective Forms 990 to determine whether they were reporting costume rental income as income subject to the unrelated business income tax for non-profit organizations. We also requested Forms 990-T, if any. As we stated earlier, we were only able to obtain one Form 990. No costume rental income was reported on this Form 990 as income from an unrelated trade or business.

For our next step, we sought assistance from the District Office of the Internal Revenue Service, Exempt Organization Group, located in Brooklyn, New York. It was suggested that we file a statement with the District Director setting forth our suspicions regarding these non-profit theatre organizations. We were informed that there was no prescribed format or procedure to be followed in preparing or submitting this statement. We were also informed that there was no assurance that the matter would be investigated and that it would be impossible for us to find out the ultimate outcome of our submission. We anticipate making these submissions in the next few weeks.

Eaves-Brooks' Present Dilemma

Our present situation is one of complete frustration. It seems that once exempt status is granted, little, if any, supervision is performed to monitor the activities of non-profit organizations, absent flagrant abuses of the tax-exempt guidelines. We have learned that the Arts Councils are not concerned if their funds are ultimately used in a commercial business in complete competition with tax-paying businesses. We understand the Exempt Organization Division of the Internal Revenue Service is already overwhelmed by merely keeping up with the 30,000 annual applications for tax-exempt status.

We have no way of determining whether we are competing on a fair playing field with these non-profit theatre organizations. We do understand and accept that the playing field is considered fair if these organizations are paying tax on their unrelated trade or business income after adjustments for subsidies and

grants that relate to such income. However, at the substantially reduced prices these organizations are charging for costume rentals, which no taxpaying business can compete with and stay in business, their purported payment of this tax is highly suspect. It appears to us that the requirement to pay this tax is almost self-regulatory.

Recommendation

Our principal recommendation to the Committee, is the formation of a Review Board for each District Office of the Internal Revenue Service where Forms 990 are filed. The Board would report to Congress directly or a subcommittee thereof. This Board would receive complaints from the public concerning asserted abuses by public charities. The complaints reviewed by the Board would not be limited to those concerning violations of the unrelated trade or business income tax rules, rather, the Board would also review complaints of suspected inurement or private benefit. The complaints received by the Board would be available for public inspection. Members of the Review Board would be comprised of individuals from the Internal Revenue Service, non-profit organizations, and business community.

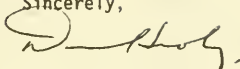
The Board would review the complaints received and determine whether the asserted abuses, if true, would violate the tax laws for exempt organizations. If the asserted abuse would violate a tax law, the Board would then direct the Internal Revenue Service to conduct an audit or examination of the asserted violation and make recommendations for the imposition of penalties, if applicable. The Board would monitor the progress and results of each audit or examination. The public should have access to the final findings of the Board including whether any penalties were assessed. The Board would also be able to provide the Internal Revenue Service with specific audit guidelines for the various business areas in which exempt organizations operate. The Board, based upon its knowledge of various abuse cases, would also be able to make recommendations to this Committee or Congress of needed legislation to correct for repeated abuses of tax-exempt laws.

CONCLUSION

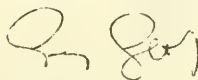
It is our hope that our comments regarding the commercial abuses performed by non-profit organizations and our frustrated efforts to combat these abuses have been helpful to the Committee. Mr. D. Thomas Lloyd, President of Adirondack Scenic has joined us in the attached statement to express his problems with non-profit organizations which are closely similar to ours. If the Committee would like additional information, we would be very pleased to

provide it, either in writing or in person.

Sincerely,

A handwritten signature in dark ink, appearing to read "D. Geoly".

Daniel Geoly
President, Eaves-Brooks Costume Company

A handwritten signature in dark ink, appearing to read "Guy Geoly".

Guy Geoly
Vice President, Eaves-Brooks Costume Company

Attachment

ADIRONDACK SCENIC INC

40 Hudson Falls Road, South Glens Falls, N.Y. 12803

Tel. (518) 747-3335

Fax. (518) 747-6738

August 21, 1993

Chairman Pickle and
Members of the Committee on Ways and Means,
Subcommittee on Oversight:

Public funding for the Performing Arts is being misused by Not-For-Profit organizations. Federal Tax Exemption is serving as a cloak for profiteering ventures. The practice is subtle, but widespread, and it is eroding the infrastructure of culture in the United States. Professional craftspeople of varied disciplines are losing their jobs because non-profit Opera and Theatre Companies throughout the Country are abusing their tax exempt status by maintaining commercial ventures with public funds. These organizations utilize their Federal grant money and Tax Exempt Status to subsidize their operations by competing in the commercial marketplace against enterprises whose very existence depends, in part, on business relationships with Not-For-Profit organizations.

I wish to add my voice to the chorus of entertainment professionals who are being victimized by Federally funded Not-For-Profit organizations competing unfairly for our business. My company, Adirondack Scenic, Inc. is a small corporation in upstate New York comprised of 50 professional artists, craftspeople and technicians who specialize in the construction of scenery and props for Opera, Theatre, and Ballet as well as for a host of commercial enterprises. It has always been our policy to cut our prices to the bone in order to capture work in the non-profit sector because it represents our background as artists as well as our contribution to these worthy ventures. Over the past ten years, our considerable client base has been nearly eradicated due to the growing number of "captive" scenery concerns working under the umbrella of their federally funded and protected non-profit nannies.

Our objection is not with those organizations who are industrious enough to build their own scenery. Most of my employees and I are products of the job training available in summer festivals and regional repertory companies. Rather, it is

with those companies whose studios have ventured into the commercial marketplace. These "shops" utilize their subsidized facilities and staff to undercut any commercial competition for work not only for other non-profits, but also for television, film, theme park, business meetings, trade shows, and other commercial attractions. The business loss for Adirondack Scenic, Inc. as a result of these organizations is conservatively ten million dollars over an eight-year span. That's a lot of taxpayer salaries, whose taxes are being used in part to support the recipients of their lost jobs.

Five years ago, upon advising Congressman Jerry Solomon of this problem, I received a sympathetic response indicating that my cause was legitimate, but it was like "asking the Girl Scouts to stop selling cookies". Perhaps times have changed. Competition has always been at the root of my business, and a firm belief in democratic capitalism has kept my company alive. People out here are trying to succeed, but the IRS and the NEA are allowing subsidized entities to unfairly restrict the business of taxpayers. I urge you to act quickly to stem the practice of unfair competition. We are firmly committed to supporting the arts, but not when the arts are slitting our throats with the aid of the Federal Government.

Yours very truly,



David Thomas Lloyd
President

DTL:too

cc: Dan Geoly; Eaves Brooks Costume Co., Inc.
Barbara J. Thomas; Squadron, Ellenoff, Plesent,
Sheinfeld & Sorkin
President Alfred W. DiTolla, IATSE
Congressman Jerry Solomon
Senator Alfonse D'Amato
Senator Daniel Patrick Moynihan
Governor Mario M. Cuomo

Statement to the Subcommittee on Oversight,
Committee on Ways and Means, U.S. House of Representatives
The Honorable J. J. Pickle (D., Texas), Chairman

Submitted by Nancy R. Axelrod
President, National Center for Nonprofit Boards
July 1, 1993



NATIONAL
CENTER FOR
NONPROFIT
BOARDS

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20036-4907
Tel 202-452-6262
Fax 202-452-6299

The one million nonprofit organizations in America today represent a significant economic force and render services of inestimable value to the nation. Some of the most important needs of American society are addressed by the educational institutions, social service agencies, hospitals, museums, environmental agencies, symphonies, and related organizations that comprise America's nonprofit sector.

The roles of and expectations for these organizations are very different from those of other sectors of American society--particularly government, with the special demands and limitations placed upon it, and business, where success is measured by earnings per share for shareholders. By creating the legislative and tax framework under which nonprofit organizations now operate, the government of the United States long ago recognized that strong, independent organizations can best meet certain needs in our society.

Nonprofit organizations can often respond to needs more quickly and efficiently than government. They are frequently more sensitive to certain constituencies, and they are not constrained by the need to make a profit for investors. The large volunteer labor force available to nonprofit organizations expands significantly the services they can offer. It is not surprising that the large, diverse nonprofit sector that has emerged in the United States as one of our distinguishing characteristics is being studied and emulated by the world's emerging democracies.

Ultimate responsibility for the governance of these nonprofit organizations is vested not in stock owners, public officials, or professional managers, but in boards of directors composed of individuals who volunteer their services. These volunteers, who come from all sectors of American society, are motivated to serve in large part by their deep belief in the mission of a particular organization.

Nonprofit board members are guided in the exercise of their organizational responsibilities by legal requirements that range from the organization's articles of incorporation and bylaws to state nonprofit corporation laws to federal tax and civil rights laws. While external agencies, such as state attorneys general and the Internal Revenue Service, exert some regulatory control, most of the responsibility for self-regulation, accountability and ethical practice rests on the shoulders of the millions of lay individuals who serve on boards.

Responsible board members act as stewards to ensure that their institutions carry out the missions entrusted to them by the public. In addition, nonprofit boards are also responsible for the organization's mission and purpose; selecting and supporting the chief executive; reviewing the executive's performance; planning for the future; approving and monitoring the organization's programs and services; providing sound financial oversight; enlisting financial resources; advancing the organization's public image; and strengthening their own effectiveness as a board.

The National Center for Nonprofit Boards was created in 1988 to improve the effectiveness of nonprofit boards by strengthening their boards of directors. The serious and well publicized practices at individual nonprofit organizations that helped bring about the hearings before this subcommittee have generated a surge of inquiries to the National Center for Nonprofit Boards from members of governing boards and staff members who wish to review and strengthen their own mechanisms for accountability. In response, we are continuing to develop governance tools to help board members carry out their critical responsibilities as stewards and guardians. These include publications and educational programs addressing the legal responsibilities of board members; procedures for evaluating the performance of the chief executive, the organization, and the board itself; and guidelines for helping board members understand nonprofit financial statements.

In Fulfilling the Public Trust: Ten Ways to Help Nonprofit Boards Maintain Accountability, a booklet recently published by the National Center for Nonprofit Boards, author Peter Bell, president of the Edna McConnell Clark Foundation and chairperson of CARE, notes that:

"Boards that hold themselves and their organizations to high standards of accountability start with individual members who are committed to giving the time and quality attention for responsible trusteeship. These board members view their service on nonprofit boards as a public trust that requires establishing a framework for accountability and exercising governance within that framework. What motivates them is not fear of the consequences from falling short, but satisfaction at the prospect of effectively advancing the social purposes of their organizations. While accountability demands discipline, board members will experience its proper exercise as less confining than liberating."

As a national organization that exists to help board members better fulfill their responsibilities, the National Center for Nonprofit Boards encourages boards to be more responsible and accountable. Legislation should not be enacted to dilute the responsibility of the governing board as the body that is morally and legally accountable for the nonprofit organization. Nothing will do more to restore declining confidence in the nonprofit sector than the actions governing boards can take to:

- o Protect the freedom and diversity of the nonprofit sector;
- o Comply with regulations that do not create an undue burden on the largest segment of the nonprofit sector, those organizations with budgets of less than \$100,000 a year;
- o Establish fair levels of executive compensation;
- o Create a climate that will not discourage volunteers from serving as board members.

The key to improving the accountability of America's nonprofits will be in helping the millions of volunteers responsible for the governance of America's nonprofits to understand and fulfill their role as fiduciaries.



July 27, 1993

Ms. Janice Mays, Chief Counsel
 Committee on Ways and Means
 1102 Longworth House Office Building
 Washington, DC 20515

re: Subcommittee on Oversight
 Aug. 2 hearing on public charities

Dear Ms. Mays:

Please include this letter in the hearing record and consider the need for a federal law that requires a charity to properly allocate "joint costs" to solicitation expense. The law should set a limit on the percentage of fundraising and administrative expenses that a charity can incur. A heavy excise tax would discourage charities that violate the limits or abuse accounting methods. Certain exceptions may be necessary for startup charities.

Books have been written on accounting for charities, but little on how charities account. Abuses are often buried in the financial statements under "education expense" or netted against "contributions".

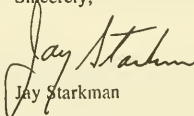
AICPA's Statement of Position 87-2 paragraph 20 establishes criteria which should require charities to list fundraising costs as solicitation expense. But it's worded vaguely, so that a flyer enclosed with the mail solicitation is used as an excuse to allocate a portion of the solicitation to "education expense". Contributors should be told when a professional fundraiser will receive a percentage of their contributions. Often his fee is misclassified as something else on financial statements.

State laws permit charities to net the cost of a fundraiser against the proceeds. For example, that \$150 a plate dinner attended by 300 people can be shown by the charity as \$18,000 "Special Events". The \$27,000 expenses goes unreported. When state laws set limits on what a charity can incur as expenses, the charity argues that it is a multistate operation, not subject to the law or regulation in question of the particular state. Or, if it can't meet the ratios in the local office, it submits national figures that the state is unequipped to deal with.

Mainstream charities consider a mail solicitation highly successful if the mailing cost is *only* 50% of the proceeds. Let IRS tell you about mailing list companies that incorporate a charity, with 90% of the proceeds going to pay for use of the mailing list. Even better, ask IRS what percentage of "televangelist" fundraising is used for a real exempt purpose, after TV production costs.

I've enclosed 2 articles which appeared in the Wall Street Journal in recent years on charity abuses. Remember, without the double benefit of tax exemption and deductibility of contributions, the abuses wouldn't be so widespread.

Sincerely,



Jay Starkman

JS:abm:x
 Enclosures



GIVE AND TAKE

Many fund-raisers think charity begins at home—their home

By ROBERT JOINSON

THE PANHANDLER APPROACHES, makes his pitch. It may be straightforward—he wants money for food, or incredibly convoluted; his sister is at this very moment near death in Hoboken, he has lost his wallet and has only \$1.22 in change to put toward a bus ticket costing \$3.53, and won't you give him the difference? No? Well, how about a loan, he'll take your name and address...

Figuring that their money would more likely go toward a bottle of Night Train Express, most people have little trouble saying no to propositions like this. But healthy skepticism vanishes when they are solicited by an organized charity to help fight cancer, famine, child abuse, or what have you. Most are little reason to doubt that their cash will go toward these noble goals. But will it?

In a distressing number of cases, no. In fact, the donors sometimes might be better off giving the money to the panhandler at least he has no overhead, and he might even be telling the truth.

Consumed by Expenses

Last year, more than \$100 billion was donated to the nation's 400,000 charities. While the vast bulk of it was infused spent by reputable organizations on the good works it was raised for, it's equally true that a sizable chunk was consumed in "expenses" claimed by other operators, including fraudulent expenses. In many cases the costs claimed were so high that only a dribble of cash was left for the purported beneficiaries.

It's impossible to say exactly how much of the total charity intake is devoured by stratospheric fund-raising costs, high-living operators, and downright fraud. But the problem clearly is widespread and persistent. State law enforcers can barely keep up with charity scams, and reports from watchdog groups such as the Council of Better Business Bureaus are not encouraging.

The Philanthropic Advisory Service of the BBB reviews hundreds of new charities every year, measuring them against minimum standards for accountability, for accuracy and honesty in solicitation; and for percentage of funds actually going to work for which the charity was supposedly established. The Service figures at least half of the money taken in should be spent on program. Roughly a third of the charities reviewed flunk the test.

Which, it should be added, doesn't prevent the charities from raking in a lot of money anyway. Without a microscope and a subpoena, it's often hard to sort out worthwhile causes from ripoffs if all you've got to go on is the solicitation itself. On this basis, "there's no way the average person can know a good charity from a bad one," says David Ormsdell, an assistant attorney general in Connecticut. "A lot of donors just get taken."

Including those, he contends, who put about \$1 million into the kitty for the Connecticut Association of Concerned Veterans and the Vietnam Veterans Service Center. The state has sued these charities in state court, complaining that much of

the money was grossly misapplied; 82%, says Mr. Ormsdell, went to fund raises and most of the rest to the people who ran the charities and to their relatives—for car costs, trips to Florida, Lucullan restaurant tabs. The telephone number for the charity in Shelton, Conn., has been disconnected, and the former officials couldn't be located.

Charities That Work

Running a charity does cost money, but reputable organizations manage to get the lion's share of donations out to where they are really needed. The Arthritis Foundation, the American Cancer Society and the United Way of America all say that they spend roughly 90% of their income on programs, not overhead. With some other charities, however, it's

ties recently. The attorney general's office in Connecticut alone has put seven of them out of business over the past couple of years, and the enforcement drive is continuing there and elsewhere.

Focusing on Misrepresentation

In making cases, the authorities frequently zero in on alleged misrepresentations made by the charities' fund raisers. Illinois, for instance, currently has under investigation 10 of the 30 companies drumming up funds for charities soliciting there.

Enforcers pay special attention to operators using sweepstakes prizes as an additional inducement to give. Attorneys general in several states, including Illinois, are already suing Watson & Hughey Co., an Alexandria, Va. based outfit that they say has used deceptive sweepstakes ads to solicit donations for the American Heart Disease Foundation and the Cancer Fund of America.

According to the Illinois attorney general's suit, Watson & Hughey sent mailings indicating that recipients were guaranteed cash prizes, and could win up to an additional \$1,000 on top of them, if they contributed as little as \$7. But the total value of the prizes was only \$5,000 and most "winners" will receive just 10 cents, according to the attorney general's office. The suit is still pending in Illinois state court. Watson & Hughey has denied the allegations in court; officials decline to comment further.

While they can target some of the most obvious miscreants, enforcers concede that they are only scratching the surface. There are so many cunning ploys used by so many dubious operators, they say, that it is probably impossible to stop them all.

One maneuver the "public education" gambit. The solicitation material indicates that donations will go toward a campaign alerting and informing the public about some health or other issue. What it doesn't say is that the entire "campaign" may be the fund raising letter itself.

"All too often this will merely be a statement on the solicitation, such as, 'Don't smoke!' or 'Wear suntan lotion,'" says William Webster, attorney general of Missouri. "By putting these pithy statements on the solicitations, hundreds of thousands of dollars are claimed to have been spent on education to consumers when in fact this represents the costs of sending the newsletters."

Win Gold Bullion

Mr. Webster cites a four page mailing from the United Cancer Council that offers a chance to win \$5,000 in gold bullion to those giving as little as \$5 to cancer education. "A few boilerplate warnings about cancer appear but that's only two inches in all four pages. I think some people may believe they're helping fund a massive TV and print campaign, but we couldn't find that [the charity] does anything except write these letters," he says. Officials at the Washington, D.C.-based charity didn't return repeated phone calls.

Many fly-by-night charities ride the coattails of the biggest, best known and most reputable ones by adopting names similar to theirs. The established charities are bothered by this but say they can do little about it. "We can't police the many organizations that have sprung up in the last few years

PHOTO BY JEFFREY M. HARRIS

Where Your Dollar Goes

Overhead costs at some of the largest charities, in millions of dollars

	1988 REVENUE	OVERHEAD COSTS
American Red Cross (Washington D.C.)	\$985.2	\$91.6 (9.3%)
UNICEF (New York)	709.0	114.0 (16.1%)
American Cancer Society (Atlanta)	335.8	85.2 (25.4%)
CARE (New York)	321.1	21.8 (6.8%)
Planned Parenthood Federation of America (N.Y.)	303.1	64.2 (21.2%)
Catholic Relief Services (Washington)	288.3	18.3 (6.3%)
American Heart Association (Dallas)	217.2	45.8 (21.1%)
Volunteers of America (Melville, La.)	208.9	23.6 (11.3%)
Save the Children Federation (Westport, Conn.)	85.9	11.3 (13.2%)
Father Flanagan's Boys' House (Beatrice, Neb.)	81.4	11.1 (13.7%)

Source: The Rand/Profit Times

the other way around.

The fledgling National Children's Cancer Society, for example, took in \$2.5 million last year to finance bone-marrow transplants for children. By the time it paid its expenses it only had \$120,000 left—not enough to treat even one child. The state of Illinois is suing the charity for fraud in Chicago, along with Telesystems Marketing Inc., its Houston-based fund raiser.

Both deny wrongdoing. The charity admits spending a lot on fund raising, but says that was necessary to establish a donor base it can tap at much lower cost in years to come. Michael Burns, president of Telesystems, says his concern has only benefited from the publicity surrounding the case, noting that three other charities have signed on as clients because they were impressed with the amount he raised for National Children's Cancer. Meanwhile, a state court judge has allowed the charity to go on soliciting funds.

Enforcers can't put charities out of business simply because they spend the lion's share of their income on fund raising. State laws previously used as a yardstick minimum percentages of income—usually half—that had to be spent on the program rather than overhead, but these have been overturned by the U.S. Supreme Court. It has ruled that such laws might work to stifle fund raising, which would amount to limiting the charities' first-amendment right to freedom of expression.

This puts upon enforcers the burden of proving outright fraud or misrepresentation, and such actions have been brought against hundreds of charities.

MR. JOINSON IS A STAFF WRITER IN THE WALL STREET JOURNAL'S CHICAGO BUREAU.

Beware!

but in the meantime all we can do is tell people they aren't connected with us," says a spokeswoman for the American Heart Association.

And sometimes a reputable charity with a household name gets used and doesn't even know it. A couple in Rockford, Ill., raised \$12,591 earlier this year using the name and logo of Mothers Against Drunk Driving, without permission from the group. MADD didn't learn of the fund raising until the cou-

ple sent it a check for \$613, along with a letter saying that was the charity's "share."

The Illinois Attorney General won a court order to prevent the couple from raising further funds without MADD's permission. The couple couldn't be reached for comment and apparently have left Rockford, law enforcement officials report. Denise McDonald, a spokeswoman for MADD, says, "It's scary, because anybody could do this." ■

CHARITY

Continued from page R6

using part of our name. Most of them don't last for long,

One Charity's Uneconomic War on Cancer

By THOMAS J. DiLORENZO

The recent controversy over the United Way's spending priorities and the resignation of its national president, William Aramony, highlights a problem that is symptomatic of other charities. Because charities tend to be judged more by their good intentions than by their performance, they sometimes escape the close public scrutiny that private businesses (and even government enterprises) receive. Constrained by neither pressures of the marketplace nor the rigors of electoral politics, many large charities suffer from bureaucratic inertia and diminished effectiveness.

Since government has proved to be incompetent in solving social problems, private charities are more necessary than ever. One such charity is the American Cancer Society, which has led the fight against cancer for almost eight decades. The ACS is widely regarded as among the most efficient charities in the U.S., but my research suggests there is significant room for improvement.

Except for medical research, most of the American Cancer Society's functions are carried out by its 57 chartered state or regional divisions. Public inquiries about the activities of these affiliates are answered with annual reports that are long on self-promotion and short on detailed financial information. Typical of such reports is ACS Florida's, which in 1990 stated that "When you give to the American Cancer Society, you can be sure that your contribution is used efficiently. More than 78 percent of all funds . . . are used in research, education, or service programs. Management and fundraising costs are kept to a minimum."

Cancer Society affiliates are able to report a high percentage of expenditures for services by counting the costs of providing the services (salaries, pensions, fringe benefits and overhead) as part of the service itself—salaries and overhead costs are rarely even mentioned in the annual reports. The audited financial statements of affiliates, however, allow the separation of the overhead costs and staff compensation from the amounts spent to provide direct services. Such an analysis leads to a significantly different assessment of the efficiency and priorities of Cancer Society affiliates.

The nearby table contains information on 10 Cancer Society affiliates in states in different parts of the country. The typical affiliate spends more than 52% of its budget on salaries, pensions, fringe benefits and overhead; chief executive officers earn six-figure salaries in a number of states. By contrast, only about 16% of the typical affiliate's budget is spent on services to the community (i.e., printing, publications and films, meetings and conferences, grants and awards and assistance to individuals).

Thus, for every \$1 spent on direct service, approximately \$6.40 is spent on compensation and overhead. In all 10 states, salaries and fringe benefits are by far the largest single budget item, a surprising fact in light of the characterization of the American Cancer Society as a "voluntary" organization.

The financial statements also reveal that Cancer Society affiliates are wealthy organizations, despite their fund-raising

appeals, which stress an urgent and critical need for donations to provide cancer services. As of 1990 the California affiliate, for instance, had accumulated \$36 million in cash, certificates of deposit and securities; Florida had set aside \$20 million; Texas, Ohio and Colorado held about \$10 million each. The average affiliate in the

bious worth. For example, the ACS has been promoting the "seven warning signals" of cancer since the 1920s. One wonders about the marginal value of additional millions of dollars spent in this way compared to other uses.

Also funded by donations to ACS is "professional" education, which involves subsidizing the costs of instructional materials, conferences and so on for health professionals. As a group, these professionals are among the highest-income individuals in the U.S., yet they are being subsidized by donors who are much less well off than they are. One wonders about the propriety of such expenditures in light of the fact that most other professionals pay for their own continuing education.

For nearly 80 years the American Cancer Society has provided valuable services to American society and, indeed, to the world. But it needs to be managed much more efficiently. ACS affiliates have diverted substantial sums away from providing cancer service in order to accumulate large holdings of cash, securities, land and buildings. More progress in the war against cancer would be made if they would divest some of their real estate holdings and use the proceeds—as well as a portion of their cash reserves—to provide more cancer services.

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How They Spend

Financial Profiles of 10 American Cancer Society affiliates

	DIRECT SERVICES (% of budget)	SALARIES & OVERHEAD (% of budget)	CASH RESERVES (in \$ millions)
Ariz.	9.5%	53.9%	\$ 3.5
Calif.	11.0	58.9	36.2
Colo.	17.7	52.3	9.5
Conn.	18.2	52.0	2.6
Fla.	18.0	48.7	20.3
Minn.	17.9	54.2	6.3
Missouri	8.6	60.0	5.7
Okla.	22.1	46.4	10.4
Texas	22.5	45.0	9.6
Whic.	11.2	52.5	4.2
AVERAGE	15.7%	52.4%	\$10.8

Source: Financial statements of the American Cancer Society

sample of 10 held \$10.8 million in cash reserves—approximately 125% of annual expenditures. Colorado holds a trust valued at \$3.3 million. The trust was established in 1966, and as of early this year, none of the principal had been spent on providing cancer services; for nearly six years the money was used solely to generate interest income.

Such asset holdings call into question both the fund-raising rhetoric and priorities of Cancer Society affiliates. If current needs are not being met because of insufficient funds, as fund-raising appeals suggest, why is so much cash being hoarded? Most contributors believe their donations are being used to fight cancer, not to accumulate financial reserves.

Cancer Society affiliates also have substantial holdings of land and buildings. Texas owns \$11.3 million in such assets, as well as a fleet of vehicles that cost \$847,206. The 56 vehicle fleet includes 11 Ford Crown Victorias for senior executives and 40 other cars that are assigned to individual staff members. Other state affiliates also own fleets of vehicles. (Transporting cancer patients from their homes to medical facilities is an important activity of Cancer Society affiliates, but such trips are usually made by volunteers in their own cars, who can take a tax deduction based on mileage.)

The California and Florida affiliates hold more than \$3 million in property; the average in the sample of 10 is \$2.9 million. Of course, real estate may be acquired as an investment, but then the question is: Is the society's mission fighting cancer or real estate speculation? If its affiliates operate as real estate investors, they should inform their donors.

Cancer Society affiliates also spend substantial sums on education programs that are of considerable value to the public. Some of them, however, seem to be of du-

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Written Comments of Mark Rosenman, Ph.D.
Vice President, Social Responsibility
The Union Institute
to
Subcommittee on Oversight, Committee on Ways and Means
U.S. House of Representatives
regarding
Public Hearing to Review Federal Tax Laws Applicable to
the Activities of Tax-Exempt Charitable Organizations
June 15, 1993

Through its Office for Social Responsibility and Center for Public Policy, The Union Institute has long worked to improve and strengthen America's nonprofit and philanthropic sector. As a university, we have undertaken applied research and engaged in other activities toward that end. We do so in the public interest, with the belief that the charitable community is the most important mechanism beyond government itself through which we take care of one another and ourselves, promote the commonwealth, and learn and practice democracy. The nonprofit sector is the critical infrastructure of civil society.

Our support for the independent, voluntary sector has not been uncritical. Through publications in the sector's news media, speeches and still other activities, we have spoken to rare abuses, shortcomings, and contradictions in the independent sector. We have urged others to do so as well. We advocate disclosure and accountability, understanding that public trust and confidence is essential both to the fulfillment of the nonprofits' mission and to the generation of the support necessary to them.

A recent spate of newspaper stories have decried alleged abuses of tax-exemption by charities and other nonprofit groups. While the nonprofit sector certainly is not above criticism, a point to which I return below, the major thrust of much current commentary has been misdirected and at times malicious. The public's attention has been focused on the very infrequent instances of egregious behavior -- such as the executive compensation scandal at United Way of America or the questionable expenditures of the Freedom Forum, and it has been drawn away from the sacrifice and contributions which characterize these organizations, their staff members, volunteers, and supporters.

The history of the voluntary, independent, nonprofit sector on these shores predates our revolution; its roots are in the colonial commons and in groups freely formed to help the needy and to advance the quality of life for all. When the French philosopher de Tocqueville visited our young nation in 1831, he marveled at these associations and their importance to our communities and our democracy.

Today, the nonprofit sector has grown large and complex, but it still serves its founding principles: to help those of us in greatest need; to alleviate poverty and cure disease; to advance education, science and religion; to lessen the burdens of government; to provide access to art, culture and recreation; to promote social and environmental justice and protection; and otherwise to attend the common good. Nonprofits are not owned by stockholders. Boards of trustees and directors represent the public's interests in governing these organizations. Any funds raised by nonprofits, through whatever means, cannot be used for private profit -- they must be applied in support of the organization's mission.

Most of us think of nonprofits as charities, those groups which survive on tax-deductible contributions, use volunteers, are characterized by sacrifice, and help those of abject circumstances. There are close to 500,000 charitable organizations

registered with the IRS today. While many mirror the public's image of charities, some have evolved into large, well-funded and fee-generating institutions which do not accord with popular perceptions. Yet, even these groups are appropriately accorded such classification.

Under other IRS tax-exempt classifications, there are also 350,000 religious institutions, and about an additional 500,000 civic leagues, associations, block clubs, fraternal organizations, and others which, together with charities, comprise the nonprofit sector. Beyond the tax-deduction the donor gets for gifts to charities, the tax-exemption of charities and other kinds of nonprofit groups (which cannot accept tax-deductible gifts) means that they do not pay taxes on revenues related to their principal mission. They also usually are exempt from local sales and property taxes.

Besides contributions, nonprofits' revenue comes from fees-for-service (usually on a "sliding scale" based on an individual's ability to pay), membership dues, sales of publications and other materials directly related to their mission, and from any earnings that they might have from investments. These investments are part of nonprofits' endowments, investments which earn interest that the nonprofit uses to help pay for its services or to reduce their cost to the public. If nonprofits engage in commercial enterprises which are unrelated to their mission, they pay taxes on that income, and remaining profit goes to support the organization's operation.

The federal government gives nonprofits tax-exemption in recognition of the fact that they serve a public function, better society and the conditions of peoples' lives, and relieve government of some of its burdens. To a large extent, federal, state, and local governments rely on the nonprofit sector to help deliver government services, provide input on program direction, and make information available to shape public policies.

Despite this historical partnership, three forces are combining to create a nonprofit backlash, an attack on the sector, if you will. The first is a lack of understanding of what the nonprofit sector does, how integral it is to each community, and how significant it can be to long-term economic growth and social stability. Only partly as a result of this misunderstanding, news media, and at times legislatures, disparage the nonprofit sector, distorting facts and exaggerating abuses.

The sector does have issues which need to be addressed. There is some abuse, and even fraud, in fund-raising. Although 75% of its chief executives make under \$76,000, there are some officials whose pay levels and perks raise serious issues. Some nonprofits behave so much like businesses that it is hard to understand what makes them different. However, the growing commerciality in the sector is in part a response to cuts in government funding -- nonprofits have been forced into entrepreneurship in order to raise the dollars needed to make up for the short-fall in public funds and programs.

In fact, during the last twelve years the federal government has encouraged nonprofits to rely less on government funds and more on philanthropy and self-generated revenues. In turn, philanthropy has urged nonprofits to develop innovative funding streams, engage in entrepreneurship and hone their income-building skills, and develop endowments -- all to decrease their reliance on foundations.

These factors are partial explanation for the seemingly endless stream of fund-raising appeals from charitable groups, some from well-established and financially secure organizations. Simply put, the need for their services grows daily in the face of government cuts and the imperative to move beyond foundation funding.



Criticism must be addressed directly and forcefully by the nonprofit sector. It stands clearly in favor of disclosure and accountability, condemns fraud and abuse of tax-exempt status, and reports its finances both to governments and the public. It has worked actively with government to increase the effectiveness and enforcement of appropriate regulations and will continue to do so. It has developed general standards of ethical practice and organizations are committed to monitoring them. And it needs to do still more, as addressed below.

However, there is little appreciation of these efforts. In fact, at times the government appears not to fully understand the sector or its value. For instance, while Congress has applauded and encouraged nonprofits' role in facilitating citizen participation in governance, currently it has under consideration two measures which would restrict charities in such endeavor -- substantive limitations on the use of nonprofit postal rates and the establishment of conflicting definitions and requirements on lobbying disclosure.

There also have been governmental initiatives to limit the free speech of nonprofit organizations by conditioning federal grant and contract support. Additionally, government is moving away from its prior commitment to help the voluntary sector serve as a vehicle for providing the information and public education necessary to fully informed democratic governance.

These developments and this Congressional hearing, at least partially in response to malevolent news media stories about the independent sector, represent a disturbing trend -- an increasing absence of "nonprofit thinking" in the federal government. Our elected and appointed leaders would better serve the Nation by thinking proactively about how the sector can work in better partnership with government to pursue multi-faceted agendas, rather than focusing attention and energy on the rare abuses of tax-exempt privilege or charitable ethics.

The second factor in the current wave of nonprofit bashing can be described as "policy by deficit." Rather than reinforce nonprofits' concern for improvement in the common good and reduction in human misery, political leadership is placing budgetary considerations at the center of policy-making. As governments search desperately for new revenue, they seek targets of opportunity -- nonprofits' tax-exemption looms large. Criticism of the sector serves to "soften the target."

At the federal level, individual tax deductions for itemizers can be taken only when deductions exceed three percent of adjusted gross income. Since the other major deductible items are fixed and not discretionary to the individual -- state and local taxes, mortgage interest -- it is charitable contributions which suffer. Additionally, as federal policy-makers consider other forms of taxation, there appears to be little concern about increasing charities' financial burdens through the possible erosion of nonprofits' exemption.

The federal problem is reflected at the state and local level. Efforts to extend property and sales taxes already have resulted in substantial costs to cash-strapped nonprofits. Rather than working for more effective partnerships with these groups and using them to leverage private contributions to help compensate for cut-backs in government services to their citizens and communities, governments instead seem eager to grab at the tax-exempt dollars used by nonprofits to pay for program budgets. Taxing the property held by nonprofits to house schools and universities, homeless and other shelters, hospitals and clinics, museums and other programs, not to mention religious institutions, is an understandable temptation, especially in our smaller communities.

However, the contribution of these organizations in providing needed services and in generating substantial employment (thereby supplementing government programs while concurrently increasing its individual income-tax base) ought not be eroded by the denial of exemption.

To make matters worse, governments themselves have even begun competing with charities by soliciting private donations from individuals, foundations and corporations. Some have even created nonprofit entities to solicit private funds to replace public expenditures.

The third force bearing down on the nonprofit sector is opposition from a portion of the business community. As more and more corporations decide that there is a profit in human services -- even in human misery, they attack nonprofit organizations as competitors. Under Presidents Reagan and Bush, there was an effort to stop the government from working with charities and other nonprofits if the services they provided were available from the corporate sector.

Additionally, there is the corporate push for the privatization of public functions. The commercial sector sees the potential for profit in everything from airports to prisons and highways, from education to substance abuse and nursing homes. Beyond being costly and inefficient, there are profound dangers in seeking private profit from public functions, be they in the province of government or the nonprofit sector. Yet, nonprofits (as well as government programs) are attacked in efforts to eliminate the competition.

However, the nonprofit sector itself does provide the basis for some of the current bashing. It needs to do more about these concerns. It has not raised its voice loud enough and often enough in the face of fraud and abuse in those rare instances when it does occur, such as in cases of self-dealing. It has not dealt adequately with the growing commerciality of some tax-exempt groups. Although some nonprofit practices do not violate the letter of regulations, they do raise legitimate questions and the sector needs to respond to them better than it has; instances of excessive executive compensation figure large among these.

A number of nonprofit organizations and leaders are increasing on-going efforts to develop effective approaches to these challenges, to clearly articulate normative and enforceable standards of behavior. They are committed to continue to collaborate with government to improve the efficacy and enforcement of appropriate regulation.

The sector, with the government's and the public's help, needs to defend itself against the current wave of nonprofit bashing. It should challenge malicious misinterpretations and distortions, and it should do better at self-policing and self-correction. The call should not simply be for more government regulation in over-reaction to rare abuse -- it ought to include a recognition of the need for more appreciation, understanding and support of the nonprofit sector, and a commitment to further cooperation and collaboration in service to people, communities, democracy and the nation.

After years and years of government cuts in programs for the needy and even for middle class communities, tax-exempt groups play an even more critical role in meeting basic needs and maintaining the quality of life for all of us. It is absurd to cripple these organizations as the result of misunderstanding, policy-by-deficit, or efforts to eliminate competition.

The news media and other opinion leaders must get beyond their search for nonprofit offenses and help the public to understand both the nature and value of tax-exemption. It is nothing but tabloid journalism to focus on examples of seeming abuse of nonprofit postal rates, or executive compensation, or commerciality, or endowment-building, or fund-raising excesses without equivalent attention to the social justification and charitable benefit of these groups, or to an accurate sense of scale and perspective of rare abuse, or adequate interpretation of nonprofit practices and privileges. While it might serve the interests of corporations wishing to find new markets in human services and of governments looking for new revenue streams, ultimately it hurts all of us and each of us.

Congressional review and oversight always is appropriate and can only strengthen and reinforce the necessary and valued self-policing internal to the nonprofit sector. Selective abuses, however, do not require universal legislation or regulation, particularly when such does little to encourage the sector to achieve the full potential of collaboration with government. It is the latter point which most needs and deserves Congress' attention.

The nonprofit sector is profoundly American. Over 50% of us volunteer in its organizations. It generally serves us well and is a model for democratic societies around the globe. As noted above, beyond government, it is the principal way we take care of one another and of ourselves. It is the infrastructure of civil society and the instrument of commonwealth. Government needs to help reinforce this infrastructure. It deserves to be strengthened, not bashed.



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