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Death by Bureaucracy

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With the spirit of Sarbanes-Oxley ever in the air, the Senate Finance Committee will hold a hearing tomorrow on the issue of financial abuses by nonprofits, and will consider draft proposals that would inflict broad new reporting and regulatory requirements on every charity operating in the U.S. This action -- which can only be described as overkill -- is in response to purported abuses discovered in the tax returns of a handful of philanthropic bodies, mainly involving self-dealing and excessive compensation.

The committee's own proposal would impose burdens that are well beyond the capabilities of most nonprofits. Of 65,000 foundations, only 46, or 0.06%, have assets over \$1 billion. Most have assets under \$50 million. And of the roughly 1.4 million public charities, about 94% have annual revenue of \$1 million or less; 98% have revenue of less than \$5 million. Most are run with small staffs and tight budgets.

These smaller nonprofits are where people with problems often find help, where research and funding begins for everything from AIDS to charter schools, where local communities organize to keep their streets beautiful, protect the environment, return the homeless to productive society and support civic institutions. This is the sector that most often preserves the texture and strength of our communities -- and that would be most hurt by many of the current proposals.

There is so little hard data on charitable abuses that it would indeed be appropriate for Congress to call for studies on the scope of the alleged abuse before imposing a new punitive regulatory regime. The few systematic analyses performed to date indicate that while there are, of course, bad actors, the incidence of abuse seems to be relatively low. And where abuses exist, they are already covered by existing laws.

Despite concerns that the IRS and state attorneys general haven't the wherewithal to adequately examine current filings, the proposals include myriad new filings at a stricter and more severe liability standard, similar to those enacted for publicly held business corporations. These additional compliance dollars will be a millstone for charities that are local and non-bureaucratic. Indeed, one of the first things donors ask about charities is how much is spent for overhead and administration; these proposals will force even more donor dollars into non-core costs for dubious public benefit.

Under these proposals, virtually anyone could see a charity's filed documents, public or private and, most ominous of all, will have standing to file a complaint -- effectively transferring a policing function to any individual with an axe to grind. Failure by a charity to file certain

documents could result in immediate revocation of its tax exemption, essentially a death penalty for a charity. Boards of trustees would face new federal liability standards and expanded legal exposure. Trustees of public charities would be subject to draconian self-dealing rules which would violate common sense, e.g. a trustee couldn't offer even below-market rent to a charity on whose board he serves.

The added costs are easily absorbed by the huge charities that already employ large bureaucracies, but they will devastate small shops with limited budgets and largely volunteer non-professional staff. New rules would limit board size -- another blow to fund-raising -- and prescribe governance policies, duties and composition.

The proposals would require the IRS to grade each charity against its definition of "Best Practices." The IRS already receives annual "Form 990s" from most nonprofits (detailing officers, revenues and expenditures), and can audit any nonprofit at any time. These proposals may clarify that process, and if so that's all to the good. But some now propose an expanded process that could put most, if not all, charities through an extensive review as frequently as every five years. This would involve submission of massive documentation to the IRS justifying the charity's compliance, restating its charitable goals and offering detailed narratives about its policies and operations, all to be made public.

Moreover, the IRS could require accreditation for the maintenance of tax-exempt status, and could contract out some of these powers to private accrediting entities. There is already deep concern on both sides of the political aisle that the IRS, despite denials, has had its auditing powers used for political purposes. Accreditation is an area where Congress must proceed with great caution. Accreditation by private organizations can be an excellent idea if voluntary and competitive, but mandatory and monolithic accreditation as a substitute for IRS oversight could stifle diversity while doing nothing to alleviate fears of misuse.

Of deep concern to many nonprofits is the proposal to scrap treating many non-cash donations at fair-market value and instead only count them at cost, which could drastically affect receipts. Perhaps most alarming is that the proposals actively discriminate against family foundations and many family members involved in such philanthropies. The proposals are hostile to meaningful family control, proposing severe limits on family-member compensation and dictating board composition. All of this would adversely affect the operation of many family foundations, important sources of charitable works, innovative funding and independent thought.

Families are also particularly critical to the creation of new engines of charitable giving: Donors either trust members of their family to share their vision and implement it, or see their family foundation as a vehicle for inculcating in their heirs a binding charitable ethic. Yet the Senate proposals prefer "professional" control of foundations, further diluting the notion of original donor intent. How does this create incentives for donors to establish new philanthropies?

Private philanthropy is the organized expression of the highest of American ideals: the belief that Americans can create wealth, and then use it generously to establish organizations that act in good faith and have the wisdom, compassion and initiative to help others, without undue reliance on government. Naturally, all wrongdoers should be punished. But surely the enforcement of

existing laws against self-dealing and abuse is a far better solution than the imposition of potentially prohibitive costs on every struggling nonprofit in America.

Ms. Higgins is a co-founder of the Alliance for Charitable Reform (www.ACreform.com), a project of the Philanthropy Roundtable.