

Panel on the Nonprofit Sector

Convened by INDEPENDENT SECTOR

Work Group Recommendations to the Panel on the Nonprofit Sector Posted for Public Comment January 26, 2005

#14: Funding for Federal and State Enforcement

I. Government Oversight and Self-Regulation Work Group Recommendations

A. Statement of Problem

There are inadequate resources for federal and state oversight of tax-exempt organizations. Over the past 20 years, funding for Internal Revenue Service oversight of exempt organizations has remained essentially constant while the size and complexity of the exempt sector has grown. Funding of oversight at the state level varies substantially among states, but all lack sufficient resources to provide adequate oversight of the rapidly growing charitable sector. While Congress initially recommended that revenues from an excise tax imposed since 1969 on the net investment income of private non-operating foundations should be used to fund the Exempt Organizations function within the IRS, those funds have never been allocated for that function. Congressional tax committees have suggested imposing new filing fees on tax-exempt organizations that would be designated specifically for IRS Exempt Organization oversight activities.

B. Recommendations

1. Government has a responsibility to fund enforcement of tax laws. Congress should ensure that sufficient funds are appropriated for adequate oversight and enforcement of tax laws related to charitable organizations. Congress should ensure that current fees, taxes and penalties paid by exempt organizations, including Chapter 41 excise taxes on private foundation investment income, are appropriately directed for exempt organization oversight activities.
2. Congress should require that the IRS implement and make public a five-year business plan for the Exempt Organizations Division that would stipulate the human and financial resources required to increase the Division's oversight, education and enforcement activities to a higher level.
3. New filing fees should not be imposed on charitable organizations until revenues from private foundation excise taxes are appropriated for their intended purpose.
4. Congress should consider mechanisms outside of the Internal Revenue Service for supplementing state funding for charitable oversight and enforcement in ways that will encourage states to engage in effective oversight programs.

Note: These recommendations have not yet been reviewed by the Panel on the Nonprofit Sector. They will be part of the deliberations by the Panel as it prepares its interim report.

C. Rationale

Revenues collected annually from the excise tax on private foundations greatly exceed the current budget of the IRS Exempt Organizations Division, but those revenues have never been allocated for their intended purpose. There should be a Congressional mandate that those excise tax revenues are appropriated as originally intended.

There has not been a study of exempt organization oversight activities and costs since the early 1970s. Given the enormous growth in the size and complexity of the sector during that period, it is critical to have a current, accurate understanding of the budget needs.

Funding for education as well as oversight should be coordinated with an appropriate plan for increased funding for state oversight activities since state offices are generally closer to smaller charitable organizations.

The IRS is not equipped to administer grants and assigning grant making responsibilities to the IRS would divert time and dollars that should be devoted to tax law enforcement and oversight. If Congress is considering supplemental funding for state charity oversight or educational assistance for nonprofits, it should consider other agencies (e.g., Justice Department) that have systems and capacity for grant administration. The Work Group discussed a number of possible revenue-sharing options that could encourage states to develop or improve the effectiveness of their charitable organization oversight and enforcement programs and plans to make further recommendations in Phase II of the Panel project.

D. Other Considerations

If new fees are introduced and “earmarked” for Exempt Organizations Division activities, there must be protections to ensure that the IRS actually increases funding for those activities rather than introducing internal “offsets” that re-allocate current dollars to other functions. Similar protections should be in place if the federal government offers supplemental funding for state charity oversight activities.

II. Expert Advisory Group Comments

The Expert Advisory Group agrees that both federal and state governments should provide adequate funding for effective administration and enforcement of the laws governing charitable organizations and for initiatives to improve the effectiveness and accountability of charitable organizations. They are concerned that continuing to press only the Senate Finance Committee to allocate all or a portion of the excise tax levied on foundations will not achieve the desired effect given that it is the appropriations committees that determine the appropriation of such funds. Accordingly, the Expert Advisory Group strongly recommends an approach that combines (1) a longer-term effort to persuade Congress to

appropriate sufficient general funds to support both effective IRS oversight of charities and a new revenue-sharing program to support effective state oversight with (2) a short-term commitment to persuade Congress to earmark for IRS exempt organizations oversight all existing and new fees (if there are new fees) and penalties imposed on charities.¹

The Expert Advisory Group believes that once policymakers understand the role and importance of the sector they may be more amenable to making available the dollars necessary for adequate oversight and enforcement of existing laws.

However, given the current federal budget deficit, the Expert Advisory Group believes that earmarking exempt organizations penalties and user and filing fees may be the only way to increase funding in the short term for IRS exempt organizations oversight. The Expert Advisory Group specifically recommends that all existing penalties and filing fees imposed on charities, as well as any new penalties and fees that Congress may impose (if such fees be appropriately called for), should be earmarked for funding of the IRS Exempt Organizations function.

¹ In the absence of specific statutory authority, an agency must deposit moneys received for the use of the United States into the general fund of the Treasury as miscellaneous receipts. 31 U.S.C. § 3302. There is an exception, however, where an agency is specifically authorized to retain money it collects. *See* 62 Comp. Gen. 70, 72 (1982). Thus the Senate Finance Committee could earmark fees and penalties for the use of the IRS Exempt Organizations function, and the IRS's use of those funds would not constitute an improper augmentation of its appropriation.