

New IRS Rules Help Donors Vet Charities

Revised Tax Form Will Make Nonprofits Reveal More About How They Spend

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Americans searching for the best places to make charitable donations are about to get more help from the federal government.

The Internal Revenue Service, the tax agency that serves as the main regulator of nonprofits, is ramping up efforts to increase charities' transparency as donors clamor for better tools to evaluate how their money is spent.

The first tangible signs of reform are happening now, as charities' annual tax form -- known as Form 990 -- gets a makeover for the first time in nearly 20 years. The changes promise to provide potential donors with a standardized, one-stop shop for information on charities amid a sea of varied nonprofit watchdog Web sites. Charities begin using the new form next year, when they report their 2008 information.

WHERE TO FOLLOW THE MONEY

- Guidestar (www.guidestar.org¹) is a one-stop shop for IRS filings.
- Charity Navigator (www.charitynavigator.org²) scores charities on a scale of 0 to 10 for efficiency.
- American Institute of Philanthropy (www.charitywatch.org³) grades charities on spending and fund-raising costs.
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The form, which nonprofits must continue to make available to donors and others on request, will now include a top summary page listing comparative financial information -- revenues and expenses -- over a two-year period. The next page requires charities to detail their organization's accomplishments during the past year, moving that information closer to the front of the form than before. Other sections ask charities to provide more-detailed information about fund raising, governance and compensation for top executives and trustees.

"I will probably use [the 990 form] more in the future because it has more due-diligence questions that I typically would ask," says frequent donor L.H. Bayley, the 72-year-old chairman of a Chicago-based investment firm who likes to scrutinize charities' missions, board makeup

and finances before donating. But he also believes the new IRS form will be "no substitute" for donors doing their own extensive homework on charities.

In recent weeks, Americans have been opening up their wallets to help victims of twin disasters in Myanmar and China. It is all part of an explosion in charitable giving. Americans gave \$295 billion to charities last year, and donations from individuals dwarfed corporate gifts and grant-making totals from the nation's largest private foundations.

The number of charities has surged about 85% over the past decade to 1.2 million, said Steven Miller, commissioner of the IRS's tax-exempt and government-entities division. During the same stretch, he said, the money they took in annually more than doubled to about \$2 trillion.

The IRS's move to shine a brighter light on nonprofits comes amid increased scrutiny over how charities spend donations. In the mid-1990s, the president of the United Way of America was convicted of bilking the charity out of nearly \$1 million for personal spending and gifts for his girlfriends. More recently, Congress has scrutinized spending patterns of various veterans' charities and questioned whether universities are devoting enough of their endowments to financial aid amid skyrocketing tuition costs.

While the IRS has lagged behind in developing new oversight methods for charities, a number of groups have cropped up online to fill the watchdog void. Most are nonprofits themselves.

For those wanting to sift through data, Guidestar.org⁵, a Web site run by Philanthropic Research Inc. of Williamsburg, Va., provides quick access to recently filed 990 forms and several guides to tax-reporting rules for charities. Most of the site is free, though access to more-customized data -- such as the ability to search for specific nonprofit executives and their compensation -- requires monthly subscriptions ranging between \$30 and \$100.

Other watchdogs, including Charity Navigator and the American Institute of Philanthropy, rank or grade charities based on efficiency assessments. Both organizations calculate so-called expense ratios, or the percentage of a group's spending that goes toward charitable programs versus fund raising, salaries and other costs. The American Institute of Philanthropy says well-run nonprofits direct at least 60% of their spending toward charitable programs, with the rest going to administrative costs.

"People want to know what the charity's going to do with their money. That's the bottom line," says Daniel Borochoff, president of the American Institute of Philanthropy.

The spending ratio is among the most controversial assessment tools for nonprofit leaders and advocates, who say such measures can be misleading and are unfair to small start-ups that generally face higher operational costs. Vetting independent contractors for long-term charitable housing projects, for instance, might be tagged an administrative expense but ensures higher ethical and quality standards when the actual program begins. In addition, spending ratios don't account for intangible impacts on a community, something nonprofit advocates say is hard to measure.

Such criticisms helped nonprofit lobbyists beat back a suggestion from the IRS that charities include spending ratios on the summary page of the new 990 form. Mr. Miller, the IRS deputy commissioner, says he expected pushback on the spending ratio but expressed "disappointment" that the agency and nonprofit sector couldn't agree on an alternative set of checklist measures that would allow potential donors to make quick "apples to apples" comparisons of charities.

Still, the new tax form provides streamlining and more detail. The form's new summary page immediately greets potential donors with comparative financial data, a synopsis of a charity's mission and an outline of a group's governance and operations. For those wishing to calculate spending ratios, the relevant data can be found in sections detailing revenue and expenses. "It's not a difficult hunt," Mr. Miller says.

Governance and compensation disclosures will be more rigorous. The revised tax form devotes an entire section to how a group is run. Nonprofits will now have to disclose whether their boards review the tax form before it is filed and what metrics organizations use to determine pay for top executives and managers. Other new disclosures include whether an organization has a whistleblower policy and how many board members are independent.

When reporting compensation, groups now have to report payouts using classic tax-filing standards found on W-2 and 1099 forms. Under certain circumstances, such as when an employee makes more than \$150,000, additional disclosures are triggered, including supplemental retirement programs and stock compensation, which nonprofit executives sometimes receive from an affiliated for-profit group.

Other disclosures include whether nonprofits provide executives or other employees with first-class air travel, expense accounts, housing allowances and personal bodyguards, chauffeurs and lawyers, among other perks.

Similarly, if a charity reports more than \$15,000 in gross income from fund-raising events or spends more than that amount soliciting donations, the new form triggers a laundry list of disclosures about the group's fund-raising activities. Those disclosures include the group's fund-raising methods and whether the charity pays anyone \$5,000 or more to solicit donations for the group.

The IRS isn't finished. Mr. Miller wants to broaden the agency's powers to more robustly monitor nonprofits. In a recent speech, he raised the possibility of restoring the agency's use of a seldom-used tactic known as the "commensurate test," which examines whether nonprofits are spending money on charitable programs "commensurate" with their financial resources.

In its most liberal interpretation, failing the test could allow the IRS to use its nuclear option: revoke an organization's tax-exempt status. The IRS is only studying the approach right now, but Mr. Miller wouldn't rule out more aggressive oversight down the line.

"We're concerned with whether charitable donations and charitable resources are being used for charitable purposes," Mr. Miller says. "There may come a time when we take a look to see if we have all the tools in our toolbox."