

**COMMENTS ON  
UNITED STATES SENATE COMMITTEE ON FINANCE  
STAFF DISCUSSION DRAFT OF JUNE 21, 2004**

July 16, 2004

Submitted by

*Elizabeth T. Boris, Director*  
Center on Nonprofits and Philanthropy  
[Eboris@ui.urban.org](mailto:Eboris@ui.urban.org)

*Linda M. Lampkin, Program Director*  
National Center for Charitable Statistics  
[llampkin@ui.urban.org](mailto:llampkin@ui.urban.org)

**Comments on U.S. Senate Committee on Finance  
Staff Discussion Draft of June 21, 2004**

**Submitted by**

**Elizabeth T. Boris\*, Director of the Center on Nonprofits and Philanthropy and  
Linda M. Lampkin\*, Program Director of the National Center for Charitable Statistics  
The Urban Institute**

The Urban Institute's Center on Nonprofits and Philanthropy welcomes the opportunity to comment on the Senate Finance Committee Staff Discussion Draft of June 21, 2004. The paper's suggestions for strengthening transparency and accountability of the charitable sector raise important issues about how to identify abuses without overly burdening the vast majority of nonprofits that provide the services so valuable to our communities and nation. We commend you on your accomplishments to date and look forward to collaborating with you in this effort.

The Center on Nonprofits and Philanthropy (CNP) at the Urban Institute was created in 1996 to help build the data infrastructure for the nonprofit sector and to use those data to conduct research on the role and impact of nonprofit organizations and philanthropy. The National Center for Charitable Statistics (NCCS), formerly at INDEPENDENT SECTOR, joined CNP as the national repository of research information on nonprofits. NCCS plays a critical role for the sector through its collaborations with the Internal Revenue Service (IRS) and state officials to improve the quality and accessibility of Form 990 data on nonprofits, which it holds and disseminates. NCCS also collects and maintains data from other relevant and reliable sources and makes these data available at little or no cost to researchers. We focus on improving the quality of the data and the data collection systems. To that end, we work with the IRS, state regulators, nonprofit practitioners, nonprofit accountants, and researchers, among others, to increase the accuracy and timeliness of the data, and to promote more informed use of the data.

There are three major points in our comments:

1. Implementation of electronic filing of Forms 990 should remain a very high priority. Electronic filing will improve the quality, access, and timeliness of data on charities, and it will reduce costs for the IRS, the states, and charities.
2. Forms 990 and Forms 990-PF collect much of the information that donors, foundations, the public, and policymakers need to know to make informed decisions, but gaps and omissions must be eliminated and better reporting must be enforced.
3. An accurate list of tax-exempt organizations must also be a priority. The current IRS Business Master File list is often out of date and inaccurate.

---

\* Any conclusions and opinions are those of the authors and do not necessarily reflect the views of the officers or trustees of the Urban Institute or any organization that provides financial support to the Institute.

## 1. ELECTRONIC FILING OF FORMS 990

**Is Form 990 Unique?** The IRS has regulatory responsibility over tax-exempt organizations, which is very different from the revenue-collecting responsibility it has over other taxpayers. The primary purpose of Form 990 is to collect information on the programs and activities of exempt organizations to ensure that they are operating in accordance with their stated exempt purpose and are not violating the rules and regulations governing their tax exempt status.

Forms 990 are unique because:

- These forms are the only source of comparable information on all tax-exempt organizations.
- The returns must be made widely available for public inspection. Organizations may be requested to provide copies of the returns that were filed with the IRS. If the organization posts the return on the Internet, either on its own web site or another web site, the posting satisfies the organization's obligation to make its return widely available.
- The forms are used by state regulators and the IRS. Most states requiring registration of charities use Form 990 information to meet their needs.

The Form 990 series of returns facilitates regulation of exempt organizations by the IRS and by state regulators. The forms also inform the self-regulation efforts of charities and the information needs of the general public.

**What are the Benefits of E-filing?** Electronic filing of Forms 990 will have the following benefits:

- Standard software for electronic filing will result in quicker and more efficient, consistent, and accurate return preparation, and the form cannot be transmitted without being complete.
- The IRS will send an electronic acknowledgment of receipt, reducing the need for correspondence between the organization and the IRS for late or lost returns.
- The IRS will assume the responsibility for public posting of filed information.

Receiving the data in electronic form will allow regulators to work on regulation rather than administration and databases. The charity regulators in approximately 40 states now require annual registration and generally require a copy of Form 990. Each state then has a costly and time-intensive process of document and data gathering, file storage, and creation of databases. Roughly half of the budgets of each state charity office are dedicated to registration management, which leaves limited resources for enforcement, public education, and other regulatory duties. Typically, it is difficult and inefficient for compliance officers to access and analyze information.

E-filing will ensure quicker and more accurate publishing of exempt organization returns, assisting donors and grantmakers in their contribution decisions. E-filing will also enable other exempt organizations, primarily research and oversight groups, to create the more efficient and

effective databases they require. For example, state associations and nonprofit umbrella groups rely on data in planning and conducting their membership and public policy programs and sector research. More comprehensive and accessible data will also assist legislators and other policymakers to better evaluate the impact of proposed changes in laws and regulations.

Benefits to the IRS will also be significant. Electronic filing will greatly increase the efficiency of IRS processing, public disclosure, and audits of returns. The current system for processing paper returns is inefficient, costly, and labor intensive. Approximately 40 percent of exempt organization returns are rejected for reasons that include the omission of required schedules, incorrect name or identification numbers, missing signatures, and mathematical errors. While IRS personnel correct many of these errors, many require correspondence with the exempt organization. This creates significant delays in processing these returns. E-filing will reduce many of the steps associated with paper processing, including mail-handling, editing, data entry, error resolution, and imaging. It will also speed the processes of answering public requests for copies of returns, examination of individual returns, and internal IRS research.

**Implementation:** Many of the problems raised in the discussion paper (the need for accurate, timely, and complete filings) can be addressed with electronic filing. But the improvements will only be available when e-filing is universally adopted.

Possible approaches to ensuring adoption by the sector include:

- Require e-filing if an extension is requested – NCCS research shows that about 70 percent of all charities file more than 5.5 months after the end of their fiscal years. As a first step toward electronic filing, if late filers were required to file electronically, the processing time and expense of a paper return would be eliminated for them, and the information available to IRS, the public, and other data users would be timely and accurate. And implementation of electronic filing would be at the 70 percent level immediately.
- Consolidate state charity registration requirements with Form 990 – IRS completion of a federal/state retrieval system to provide a single-point filing system for charities is planned and must be a priority. This system will greatly reduce the costs of compliance for charities and provide an incentive for charities to file electronically. States should also consider introducing incentives (discounting the costs of state registration if forms are e-filed, for example).
- Require paid preparers to file electronically – A current legislative proposal would require paid preparers to e-file Forms 990. The passage of this proposal would spur the commercial software developers to add an e-filing option to their existing programs. Currently, many are hesitant to invest in making the necessary changes to their software because the nonprofit market is a small one.

## **2. REVISIONS OF FORMS 990 AND FORMS 990-PF**

NCCS has a long history of working with the IRS on improvements to Forms 990. For the past fourteen years, NCCS has convened annual meetings between the IRS Tax Exempt Division staff and representatives of the National Association of Attorneys-General/National Association of State Charity Officials, along with influential stakeholders from all areas of nonprofit accountability. We have provided a forum for sharing ideas and suggestions with IRS officials that has led to detailed recommendations for changes in Form 990 and its instructions. Many have been implemented by the IRS.

As electronic filing becomes a reality, it is time for detailed discussions about changes to the forms. Some of the proposals in the staff discussion paper are difficult to address based on the information currently available from Forms 990.

For example, the Urban Institute, the Foundation Center, and GuideStar are currently working on a research report on the 10,000 largest foundations in the United States. The research to date shows that 80 percent of the 10,000 largest foundations do not pay any compensation, but the Form 990-PF does not differentiate staff from board officers, limiting our ability to study board compensation. This is an area that should be changed on the form.

Another area of concern is the reporting of “professional fees” on Form 990. Fees paid to professionals for fundraising, accounting, and legal services are reported in lines 30, 31, and 32 respectively. However, a large number of other professional and contract service fees are lumped in with other expenses in line 43. These other professional and contract service fees are substantial and cannot be readily separated because they are often summarized along with many other expenses in line 43 and only detailed on an attachment. An NCCS study of line 43 expenses found that one-third of these “other expenses” were related to professional and other contract service fees. Better detail is required on the form.

Issues such as these can be addressed with changes to the forms themselves. Many of the problems outlined in the Senate Finance Committee Staff Discussion Draft, however, concern compliance with the existing reporting requirements. For example, some filers do not divide their expenses into the categories listed on the form but group them as “other expenses” that are detailed on an attachment. Often the categories of expenses can be put into the existing lines on the forms. An NCCS study of IRS Form 990 data found that 25 percent of all expenses are currently reported in line 43—Other expenses. Thus, comparisons among organizations are difficult. IRS attention to ensuring compliance with the instructions could make this information uniform and useful.

Form 990 is the existing financial reporting standard for nonprofits. When the federal/state standard form was developed and agreed upon by federal and state charity officials in the early

1980s, the line items were based on the *Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations (The Black Book)*, the only nonprofit sector “industry” standard at that time. Since then, Generally Accepted Accounting Principles (GAAP) have changed somewhat but a section was added to the Form 990 to account for required modifications. There currently is no other “industry” standard. And there is also no standard for the financial statements that many want to substitute for Form 990.

Again, Form 990 is designed to provide information to regulators that will help them determine whether a charity is complying with regulations covering tax-exempt organizations. Research comparing audited financial statements with the Forms 990 filed by the charities found that most of the variables that should have matched did match, and that the Form 990 information was reliable. There are some areas where there is a conflict between Form 990 and GAAP requirements, but requiring more audited statements will not solve the problem and will add a major expense for many charities. These areas should be carefully reviewed and should include discussion with the Financial Accounting Standards Board before changes are made.

### **3. PROVISION OF ACCURATE LIST OF TAX-EXEMPT ORGANIZATIONS**

The discussion draft proposes a process of a five-year review of tax-exempt status by the IRS. In fact, the annual Form 990 filing already provides the information needed by the IRS to determine if an organization is meeting the requirements of tax exemption. It is our understanding that the IRS is identifying organizations for review based on information now filed on their Forms 990. IRS now has the data needed to review tax status on an annual basis, and its resources are better allocated to examining the problem organizations rather than the overwhelming majority of nonprofits that are clearly compliant.

There is, however, a major problem with keeping an accurate list of tax-exempt organizations. The Business Master File (BMF) is full of defunct organizations and bad addresses. This list is supposed to contain all organizations that have requested tax-exempt status and received recognition from IRS. This includes many that are below the Form 990 threshold of \$25,000 in annual gross receipts. Many of these small nonprofits do not inform the IRS when they cease operations and IRS efforts to update the list are sporadic. And this is the list that taxpayers are supposed to rely on when verifying that their tax-deductible contributions are in fact being made to charities.

One solution to creating a more accurate list is to require an annual report from all those with tax-exempt status, whatever their size, perhaps a “Super EZ” form that would require the Employer Identification Number (EIN), public name, telephone number, organizational e-mail address and web site, a certification that gross receipts and total assets are below the statutory limits for filings, and the signature of an officer. Making this submission electronic would speed processing and help ensure accuracy and timeliness of the list that is crucial for so many users.

## **CONCLUSION**

We hope these comments will be useful in developing approaches to improving the transparency and accountability of the nonprofit sector and would welcome further discussions.

Thank you for the opportunity to comment on these issues that are so important in preserving the vibrancy and legitimacy of our nonprofit sector.