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## Lawmakers React to Incomplete Disclosure of Charitable Asset Diversions.

Recent reports that some charities are understating the extent of their losses from the unauthorized diversion of their assets have attracted the attention of Congress.

Several members of the congressional taxwriting committees have reacted in recent days to an October 27 article in The Washington Post reporting that, based on the newspaper's analysis of filings between 2008 and 2012, more than 1,000 nonprofits reported on their IRS information returns a significant diversion of charitable assets due to embezzlement, fraud, theft, and other improper uses of funds. The article also said some charities reporting the diversions on their Form 990, "Return of Organization Exempt From Income Tax," routinely left out details about the losses, with about half the filers not disclosing the total amounts lost.

House Ways and Means Committee Chair Dave Camp, R-Mich., said in a statement provided to Tax Analysts, "It is vital that nonprofits account for, and accurately report, how their funds are used, even when the worst happens and funds are misused. Misrepresenting the loss of charitable donations due to mismanagement, fraud or embezzlement diminishes the trust we put in nonprofit organizations."

Senate Finance Committee member Chuck Grassley, R-Iowa, said the public should know when charitable dollars are diverted to non-charitable activities. "Without this kind of disclosure, law enforcement and charitable donors might never learn of diversion," he said in a statement.

Grassley on November 1 also sent a letter  to the American Legacy Foundation, which, according to the Post, lost $3.4 million through embezzlement by a former employee but told the IRS simply that the amount of the loss was more than $250,000. The foundation told the Post it did not report the total amount lost because a Justice Department investigation was underway at the time, an explanation Grassley found troubling. He posed 30 questions about the foundation's actions and asked for a response by November 15.

Inadequate Enforcement?

The Post quoted charity specialists as saying there is no established penalty for organizations that fail to disclose the full extent of the improper diversion of their assets.

But charity specialists contacted by Tax Analysts following the Post article's publication said penalties are available but for various reasons are not enforced. Jack Siegel of Charity Governance Consulting LLC, who also spoke with the Post, said that if the code is parsed, penalties for making false statements can be found. However, he added that penalties for perjury are limited because failure to fully disclose is not necessarily perjury.

"There's only so far these folks can go," Siegel said of the IRS.

Siegel said that with any rule that requires a written disclosure of facts, there will be discretion in how much one will be required to disclose. “I think charities take advantage of that fact, and as a practical matter there’s only so much the IRS can do,” he said.

Another limitation, Siegel said, is that the exempt organizations function in the IRS Tax-Exempt and Government Entities Division is not really a revenue-producing operation. Rather, it is tasked with ensuring that organizations comply with the tax laws. “And so there is, from an enforcement standpoint, [a question of] how many resources do you want to put into going after people,” Siegel said.

Gary Snyder, publisher of the newsletter Nonprofit Imperative, who also was quoted in the Post, said the IRS does not have enough staff to enforce the disclosure requirement. Another problem, he said, is that the IRS has assured organizations that the section of the information return that asks about their governance practices will be used only for data collection and not enforcement.

“The IRS just does not care or does not have the resources to care,” Snyder said, adding that the IRS audits less than 1 percent of all exempt organization returns.

Snyder said Congress has done little about the problem and that state attorneys general lack the resources to address it.

Elaine Waterhouse Wilson of the West Virginia University College of Law agreed that many state attorney general offices are poorly equipped to address incomplete reporting of diversions. Although some states — Illinois, Massachusetts, New York, and Pennsylvania, for example — are active in charity oversight, for many others it isn’t a priority, she said.

“From a resource allocation point of view, they just don’t have the wherewithal to go after that, unless they saw the underreporting as kind of part and parcel — almost like a conspiracy with the embezzler,” Wilson said. She added that some states have no one dedicated to charity oversight and that other states do not believe in regulating charities.

A possible solution, Wilson said, would be for information returns to ask more straightforward, unambiguous questions about the misuse of charitable assets that would not allow for vague or misleading answers.

In a November 1 follow-up story published on washingtonpost.com that discussed congressional and state reaction to the original article, the Post reported that officials from several state charity regulators said they would act on the newspaper’s findings.

‘Embarrassment’

Snyder attributed the tendency of some charities to downplay the extent of diversions to embarrassment. “We have a situation where nobody wants to deal with the problem at hand . . . because they’re embarrassed,” he said. “It’s a huge problem that nobody wants to deal with, including those that are sending in their IRS forms.”

Siegel said charities that fail to tell the whole story are worried about how their donors will react and, in some cases, how grant-makers and government agencies that fund them will respond. He added that charities are sometimes reluctant to give too much detail because they fear the possibility of defamation, particularly if there has not been a final criminal adjudication.

According to Snyder, the problem needs more attention from the press. “Unless it becomes a public issue where the media have gotten involved, nothing happens,” he said.

Siegel said the press and public should pay more attention to charities' information returns. "To the extent donors take the time and look at a [Form] 990 . . . it puts a donor on notice, and certainly they have the right to call up and say, 'Before I write my check out, tell me what happened,'" he said.

The IRS did not respond to a request from Tax Analysts for comment.

by Fred Stokeld