

## The Coming Revolution in the Charitable Sector (Part 2 of 2) Part Two: An Opportunity for the New IRS Commissioner

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The information returns of nonprofit organizations will soon be available at little effort and cost to almost anyone who wants them. Even modest curiosity about the activities of charities or of the charitable sector soon can be satiated easily. This exponential increase in availability of information will revolutionize the sector and its dealings with the public. It will change the very nature of enforcement from an IRS-centered universe to one of public monitoring. These events, moreover, present the new commissioner with a unique opportunity to show how the IRS can meet its broader mandate to serve the public in a way that both improves compliance and reduces costs.

Here is what is likely to transpire. Start with individuals wanting to know a bit more about a particular charity. With quick, perhaps instantaneous electronic access to the forms filed by charities, they will be able to determine information about the size and operations of the charity, the amount of funds it receives from different resources, whether its staff is paid or purely voluntary, and so on.

In some cases, the information may be used directly to inform a decision of whether to make a charitable contribution. In other cases, an individual may cross-check this information against other sources, such as brochures put out by the nonprofit organization, or claims made verbally by representatives of the organization. Do assertions of public purpose match up well with what is seen on the information return? Do administrative, payroll, and other costs seem reasonable relative to the mission of the organization? If things seem out of order or hint at illegal or unethical activity, the individual may contact either the charity itself or an appropriate public agency about these concerns.

But individual monitoring of particular charities is just the beginning. With newly available data files on charities, it is now possible to undertake research on the sector itself in ways never before possible. Suppose researchers want to perform an analysis of the activities of human service charities in the Cleveland area. Access to information on the tax returns would allow them quickly to identify many of the charities in the geographical area that are classified as human service organizations, plus perhaps some others with closely related activities. They can then get a sense of the size and ability of charities to deal with various social needs in and around Cleveland. They can also supplement what they learn by using a sample of these returns as the base on which a further survey would be conducted -- perhaps contacting the charities directly. Since the forms already provide much information, the researchers can focus their questions on details not already known. They also can tell easily whether the charity is providing information consistent with what is filed. Contrast this modern technique with the older, much more labor-intensive, effort of trying independently to find charities in the Cleveland area (through phone books, contacts, umbrella organizations), asking them how they might classify their activities, attempting somehow to insure that the resulting sample is representative of a broader population, and then starting at ground zero with questions that already could have been answered by access to tax returns.

The press will also be newly empowered to do studies on the nonprofit sector -- a sector the press has been slow to engage. Many newspapers don't yet even have a single reporter assigned to a sector that, including volunteers, employs about one-tenth of the labor force. That may change soon. With vastly expanded information sources, it will now be much easier to generate stories on a regular basis at a much lower cost of time.

One consequence is that more reports of potential abuse, or of charities operating inadequately for the public purpose, are going to be generated. While this goes hand in hand with increased accountability, the fear of some in the charitable sector may be that this information will sometimes be abused -- as when a start-up charity temporarily has high administrative costs relative to activities benefiting the public, or when the

salaries of top officials are reported without at least some comparison to salaries they could have obtained elsewhere.

But I expect that most of the reports will also be favorable to charities, giving broader publicity to many efforts to build up civil society. I would also expect reporters to perform some of the analyses to which I referred above with the example of a study on Cleveland-based human service organizations.

In aggregate, then, greater public knowledge is likely to be beneficial to society, But knowledge is still subject to abuse, and the nagging fear about misinterpretation -- whether by journalists or individuals -- is not without basis. Fortunately, there is something that each charity can do about it. They can simply file better and more informative returns. Such efforts would minimize misinterpretation. Along the way, nonprofits can work with others to improve the accuracy, relevance, and simplicity of the return.

As for legislators and other policymakers, better quality information could enhance decision-making considerably. Soon it will be easier to gauge the impacts on society of the nonprofit sector and its many subsectors, and to assess its role relative to the government and profit-making sectors.

Now for the IRS. For years, its Exempt Organization (EO) division has played the dual role of potential leviathan to the charitable sector, an unwanted stepchild to the IRS. Because of tax exemption and the charitable deduction, the monitoring of charitable sector activity at the federal level has largely been left to IRS. To the charitable sector the IRS is like the SEC, the Justice Department's Antitrust Division, and the Federal Trade Commission to an industry. Yet handling exempt organizations is not a task that the IRS necessarily has wanted. Protecting the Treasury from tax avoidance is the traditional way it has interpreted its mission, and there are hardly any revenues to be raised from the nonprofit sector. Many public concerns with the sector have more to do with how "charitable" its activities really are, how it "advertises" what it does, and so forth.

Historically, the IRS often zoomed in on revenues from compliance as the measure of its success. The recent National Commission on Restructuring the IRS, led by Sen. J. Robert Kerrey, D-Neb., and Rep. Rob Portman, R-Ohio, identified this narrow focus as one that detracted from the IRS's ability to serve the public, its "consumers." Perhaps nowhere has this been more true than with the neglect often shown to EO activities. But to be fair to the IRS, it never has been given -- and still is not given -- the resources necessary to properly monitor the hundreds of thousands of nonprofit organizations that file with it.

Here, then, lies a golden opportunity for the new commissioner. Seldom have the forces for changing the enforcement function been more aligned. In truth, in any democratic society it is almost always the public that monitors itself, using the public sector as one instrument, not the source, of power. Since the Forms 990 filed by nonprofits will soon be obtainable quickly and easily to the public, it can now take on much of the monitoring that the IRS could never do.

While the forces of technology make this revolution possible, they still must be channeled. The IRS can help matters here enormously by aiding in the process of making preparation of the return simpler and yet more informative. It can improve the delivery of data files to the public, so that the public's effort itself is more timely. The IRS can speed up the process of accepting electronic returns both to reduce errors and to make the returns more easily accessible (as opposed to waiting for nonprofit organizations to convert the data from scanned picture images, an alternative that is very costly to the nonprofit sector). Finally, while such efforts themselves will help increase the visibility of returns and provide an incentive for nonprofits to report more accurately, the IRS can more directly and publicly encourage greater accuracy in reporting -- not as a threat, but as a friendly warning that future misinterpretation may otherwise occur.

Why would the IRS and the new commissioner want to devote some attention to the handling of nonprofit organizations? For one, these organizations represent a large part of their "customer" base, even if one that has traditionally been largely neglected. More importantly, rarely is one able to find such a win-win situation. Devotion of a little effort to public relations, improving return preparation, encouraging electronic filing, and making easier the conversion of IRS data into publicly available data involve only very modest IRS resources. The gains achieved in public monitoring of the sector, and the inevitable feedback effect of more accurate reporting in the presence of increased visibility, will be quite large by comparison. With more public monitoring, the IRS fulfills much better its public service role with respect to nonprofit organizations and in the long run reduces its own costs. With better quality information, better decisions on both policy and administration are likely. There is another side benefit in that the processing efforts made here by EO and the IRS Statistics of Income (SOI) Division have broad application to other parts of the IRS, including finding ways to improve the now very inaccurate "Master File(s)" of tax returns, reducing duplication of effort because Master File and similar data are considered so inaccurate that data are reentered for other internal purposes, and increasing knowledge on how to use electronic filing and to reduce other processing costs.

The efficient use of modern computer capability, attention to its broader public mandate, the better service of customers, a more informed public policy process, and better compliance at reduced cost to the public -- these are among the goals sought for the new IRS by both the Congress and the commissioner himself. Through a unique set of circumstances, exempt organizations provide an ideal area in which to showcase that these goals are achievable.

## Other Publications by the Authors

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