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Grassley Launches Investigation of Misleading Charities

WASHINGTON – Sen. Chuck Grassley, a leader of the Committee on Finance, has asked the General Accounting Office to investigate deceitful charities that pocket donations instead of devoting them to charitable acts and receive undeserved tax breaks.

"Americans give generously to charities," Grassley said. "They deserve assurances that their donations are going toward legitimate charitable activities. Deceitful charities are a social blight. They drain money from real needs. The IRS should shut them down."

Grassley asked the General Accounting Office to investigate tax records that will help to determine the reach of deceitful charities, as well as whether the IRS is doing enough to discern deceitful charities from high-performing charitable organizations. Grassley expects a General Accounting Office report in several months.

Grassley's letter to the General Accounting Office follows.

June 29, 2001

Via Facsimile (202-512-9096) and Regular Mail

The Honorable David M. Walker
Comptroller General
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Re: GAO Request, 501(c)(3) Charities Audit

Dear Mr. Walker:

Charitable contributions in the United States exceeded $203 billion last year, up 3.2 percent from the previous year, adjusted for inflation. The Internal Revenue Code (IRC) exempts charities, also known as Section 501(c)(3) entities, from federal income taxes. This exemption rests on performing some charitable purpose as well as meeting other conditions. The Internal Revenue Service's (IRS) Tax Exempt & Government Entities division charges 850 employees with approving and overseeing more than one million tax exempt entities, including more than 750,000 charities.

Given the enormous funds contributed to an ever-expanding number of 501(c)(3) tax-exempt organizations, it is not surprising that a number of these organizations are not used for the charitable purposes for which they were created, but rather as vehicles to defraud taxpayers who believe they are contributing to a worthwhile cause. These so-called charities raise millions of dollars in donations through misleading and otherwise questionable fund-raising tactics, but they spend only a small percentage of those amounts, if any, on legitimate charitable activities. Instead, contrary to what donors are generally led to believe, the bulk of the donated funds is used to pay exorbitant fund-raising fees as well as excessive salaries, consulting fees, and other administrative expenses.

The problem appears to be particularly prevalent in the field of charitable wish-granting organizations. Perhaps because of the compelling nature of their mission, such organizations appear to be especially prone to exploitation. Although there are many credible and ethical wish-granting organizations in the United States, a number of unscrupulous individuals have apparently found raising money to grant sick children's wishes to be pretexts for fraudulent and deceptive fund-raising practices. A recent *USA Today* article reported that one such organization spent "not one cent" of the almost $3 million it raised through telemarketing on actually granting wishes. Four other wish-granting charities profiled in the article spent a combined total of less than $2.8 million of the $31.4 million in contributions they took in collectively on wish fulfillment, amounting to less than 9 percent of total contributions. States have been investigating and prosecuting questionable wish-granting organizations and other charities that have mislead donors or misused donated funds.

Additionally, the Internet has opened up endless fund-raising possibilities for both large, well-established charities and small, recently-formed charities. Soliciting on the Internet has raised millions of dollars for charity, but has also opened new doors for fraud. Because of its rapid growth and increasing visibility, the IRS must consider the enormous potential for abuse by fraudulent 501(c)(3) entities that solicit on the Internet.

I question whether the IRS is best utilizing its resources to detect "fraudulent" charities or, at a minimum, to detect false reporting by approved 501(c)(3) entities. The IRC requires every organization that is exempt under its section 501 with gross income in excess of $25,000, with certain exceptions, to file an annual, informational return (Form 990) to itemize certain income, receipts, and disbursements. However, a significant number of the IRS Forms 990 filed by approved 501(c)(3) charities contain material omissions, misrepresentations or falsifications.

Similarly, numerous charities are not complying with IRS rules and are misleading the public about how charitable donations are being used. Last year the *Chronicle of Philanthropy* reported that more than one-fourth of the nonprofit organizations that received $500,000 or more in gifts from private sources failed to report any fund-raising expenses on their Forms 990 for tax year 1996. This failure to report is amplified by the fact that those organizations received more than 90 percent of the total donations that charities of all sizes reported to the IRS. The *Chronicle* reported that improperly reporting find-raising expenses "is likely to have few, if any, consequences for a charity."

Although most charitable organizations are worthy organizations that deserve to be generously supported, it is unfortunate that many are fraudulent, employ deceptive solicitation practices, or mislead the public by submitting false or inaccurate Forms 990. Example after example of charities misusing funds for improper or illegal purposes necessitates congressional action. Accordingly, I request that the General Accounting Office study how charities use their funds and how the IRS oversees such uses. Specifically, I request a study to address the following questions:

1. How much have charities spent for charitable purposes (i.e., program services) as compared to fund-raising and "management and general" purposes during each of the last five years? Please organize the information by the type of services such charities provide.

2. Many charitable organizations report on their Forms 990 joint costs that are allocated to both fund-raising and educational activities. For charitable organizations that report joint costs, how much is allocated for fund-raising and how much to educational activities?

3. How does the IRS ensure compliance by charities with federal tax laws and regulations? Please include in your response the following information:

    a. The number of revocations of 501(c)(3) status in the last five years.

    b. The number and type (i.e., using a classification code of the National Taxonomy of Exempt Entities or otherwise) of 501(c)(3) entities audited in the last five years.

    c. The percentage of charities audited in the last five years.

    d. The number of 501(c)(3) entities upon which the IRS has imposed intermediate sanctions as a result of an audit or an examination since implementation. Also, please provide the number of intermediate sanctions the IRS has imposed, and the number that the IRS collected in the last five years.

4. How is the IRS monitoring charitable solicitation on the Internet, with particular regard to efforts to prevent fraud?

5. What procedures should the IRS implement to improve its enforcement of tax-exempt organizations? Specifically, in what ways could the IRS work with state regulatory agencies to oversee the nonprofit arena more efficiently and effectively?

As you proceed with this request, I appreciate your keeping my Committee staff informed of your progress.

Sincerely,

Charles E. Grassley
Ranking Member