Top Nonprofit Issues for the Commission

FOCUS Interviews Michael Batts, Commission Chairman

COMMISSION ON ACCOUNTABILITY AN POLICY FOR RELIGIOUS ORGANIZATION

Nonprofits are more in the spotlight on Capitol Hill now than at any time in many years. This focus is primarily due to a three-year investigation by Senator Charles Grassley of six nonprofit ministries organized as churches.

The Senator closed his investigation in January 2011 and turned to ECFA to facilitate obtaining input from the religious and broader nonprofit sector regarding a litany of tax and policy issues.

In response, ECFA formed a national commission, the Commission on Accountability and Policy for Religious Organizations, to conduct a multi-year study of these issues. For this article, we interviewed the Commission Chairman Michael Batts.

FOCUS: Senator Grassley's staff report stated: "Charitable organizations are frequently criticized for the compensation packages they provide to their officers, directors, trustees and key employees, especially when the packages include luxury vehicles and private jets." Related-party transactions and non-arms-length transactions are another frequent complaint. What are the key issues relating to compensation being studied by the Commission?

Batts: There is a focus on how nonprofit executive compensation is established. In our direct discussions with Senator Grassley, he has made it clear that his concerns relate more to the process used to set compensation for their leaders than to the amount paid. Of course, the two issues of process and amount can be very related—if the process is not appropriate, unreasonable and excessive compensation can result.

Current law provides something of a safe harbor for nonprofits that follow certain procedural steps in setting executive compensation. If independent members of an organization's board (or an independent body authorized by the board) establish the compensation using valid comparability data, and document the decision contemporaneously (following the specific requirements of the Regulations), the compensation is presumed to be reasonable. This is called the "rebuttable presumption of reasonableness." It is "rebuttable" because the IRS can challenge the presumption and overcome it; but to do so, the IRS has the burden of proof. Without the rebuttable presumption of reasonableness, the IRS can simply assert that compensation is excessive and the IRS is presumed to be correct—the burden of proof is on the nonprofit organization and its leaders.

"The focus on executive compensation is more on the process used to set compensation than the amount paid."

For rather obvious reasons, the nonprofit community really likes the protection afforded by the rebuttable presumption of reasonableness—nonprofit board members can follow prescribed steps and know that their compensation decisions are presumed to be reasonable. When applied in good faith, the rebuttable presumption process is helpful and healthy for the nonprofit sector.

However, Senator Grassley's staff noted certain ministries engaged professional compensation consultants and the compensation studies they performed compared the ministers to celebrities like Oprah Winfrey and others, claiming that their television and media presence were comparable to that of the high-profile ministry leaders. There are many who believe that comparing ministers to media celebrities as a basis for justifying very large nonprofit compensation is an abusive practice. The Grassley staff report includes a recommendation to eliminate the rebuttable presumption of reasonableness in order to prevent such abuse.

So, one of the main questions we are trying to address is how we can continue to have a plan whereby nonprofit board members can set compensation in good faith for their leaders and know that they have some protection from an IRS challenge. At the same time, we need to have a filtering mechanism that prevents abuse by those who would take unfair advantage of such protections in the law.

In addition to compensation, all of these principles apply equally to related-party transactions, which are currently covered by the same rebuttable presumption rules under the law.

FOCUS: Some of the issues raised by the Senator's staff relate to the clergy housing allowance. While this is clearly of significant importance to churches, there are many parachurch organizations which designate a housing allowance for certain clergy employees. How do you evaluate the housing allowance issues being studied with respect to parachurch organizations?

Batts: Yes, there are many clergy in parachurch organizations who are considered to have ministerial status for tax purposes. The Commission is looking at several clergy housing exclusion issues.

The clergy housing exclusion is currently under attack in the courts as a group has charged that it is unconstitutional. Some suggest the tax law should be modified in an effort to protect the constitutionality of the exclusion.

In a 2010 case (Driscoll v. Commissioner), the IRS challenged a minister's exclusion for a second home under the premise that Congress only intended to provide the income tax exclusion for one home. The minister in this case had a second home that was on a lake. In a 7-6 decision, the Tax Court ruled that

the exclusion is not limited to one home.

This ruling has caused consternation on Capitol Hill because prior to the court's decision, virtually everyone understood the law to permit an exclusion for only one home.

In a report prepared by Senator Grassley's staff, an observation was made that one minister under investigation lived in a ministry-owned home that had been valued by the local tax authorities at more than $6 million. It is likely that neither Congress nor the taxpaying public expected ministers to live in $6 million parsonages. Some have suggested that the clergy housing exclusion should be limited.

Another facet of the clergy housing exclusion issue is an assertion in the Grassley staff report that some churches ordain large groups of employees in order to take advantage of the clergy housing exclusion. If done for that reason alone, many would view such a practice as abuse.

"Some suggest the tax law should be modified in an effort to protect the constitutionality of the housing exclusion"

So I think you can see clearly how this one issue alone could have pervasive implications to ministers employed by parachurch organizations, in addition to those employed by churches.

FOCUS: In the last few years, the IRS has added certain questions to the Form 990 that, if fully implemented, could have placed ministry workers in harm's way. How would you summarize these issues being considered by the Commission?

Batts: The IRS Form 990 is the annual information return that nonprofit organizations file with the IRS providing information about their finances, governance, and activities. Once filed with the IRS, the Form 990 is made publicly available on the Internet. Current federal law requires that the Form 990, as filed, be made public with the exception that identifying information about donors is redacted. Form 990 was revised in 2008 by the IRS, and the current version of the form includes schedules that require the filing nonprofit organization to provide information regarding international activities, including grants and direct charitable, religious, educational, or similar activities.

When the IRS released its first draft of the revised 2008 Form 990, it would have required filing organizations to provide specific information about the nature of their activities in specific countries and the locations where activities are conducted. ECFA and many nonprofit organizations protested that requiring such information in a publicly available document would put people and organizations at risk. Organizations providing humanitarian or religious aid in hostile environments often depend on being able to do so discreetly in order to protect their workers.

As a result of the numerous protests, the IRS modified the 2008 Form 990 and its instructions so that it no longer required highly detailed information about foreign activities that could put people in harm's way.

"The political speech issue will likely be the most controversial of all the issues considered by the Commission."

The IRS recently requested public input on the same issue—whether such information should be required in Form 990. It is not clear why the IRS considered it necessary or appropriate to reconsider such a serious issue that seemingly had been definitively addressed previously.

FOCUS: Current law is interpreted by the IRS as prohibiting political campaign intervention by 501(c)(3) organizations. These organizations must not "participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to), any candidate for public office." This prohibition on political campaign intervention is referred to as the "electioneering prohibition." Should this prohibition be relaxed or modified to permit limited speech in support of or opposition to political candidates?

Batts: This issue will likely be the most controversial of all the issues under consideration by the Commission. Very strong views come from both sides as to whether more freedom in this area would be good for churches and the broader nonprofit sector. Regardless of one's view about the answer to that question, it seems reasonable to conclude that the current situation, as administered by the IRS, is untenable. We have churches in America intentionally engaging in activity that they believe violates the IRS's interpretation of the law. These churches send documents evidencing their conduct to the IRS along with requests to be audited in an effort to generate litigation on the issue. The IRS is not currently taking the challenge for reasons that are not clear. In a country based on the rule of law, an unresolved conflict of such magnitude is not healthy and does not bode well for a system of justice that is to be respected.

The Commission encourages you to provide input on the issues above (and others noted on the Commission website). The deadline for input is March 31, 2012.

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