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The IRS Cracks Down on Small Charities

The government has no business deciding what causes are worthy of support.

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For many small charities in the United States, May 17 may be remembered as the day their tax exemptions died. This was the deadline for charities with annual revenues of less than \$25,000 to file Form 990 with the IRS.

The IRS uses Form 990 to verify that charitable organizations meet the conditions for receiving tax-deductible contributions and qualifying for tax exemptions. Until now, the smallest charities did not have to file 990s. But thanks to a seemingly minor provision of the 2006 Pension Protection Act, more than 400,000 additional nonprofits—nearly half of public charities registered with the IRS—now have to do so. If not, the IRS will take steps to revoke their tax-exempt status.

Supporters say the new filing requirement will prevent tax privileges from going to organizations that do not deserve them or may no longer even exist. But many smaller charities are unaccustomed to submitting these reports and unprepared to assemble the necessary information. They may not file and may find themselves newly liable for taxes. If they want their tax exemptions reinstated, they will incur the costs of new filings and legal fees.

With recession-strained budgets, these small charities can ill afford any new expenses. Even more worrisome are some of the larger implications of the growing scrutiny by the IRS and state agencies.

The increased scrutiny stems from two main sources. One is a drumbeat of accounts, in congressional hearings and newspaper exposés, of apparently scandalous behavior by nonprofits—excessively high salaries, exaggerating the value of donations, and questionable financial and governance practices. The stories strongly suggest that much illegal and unethical conduct is going on in the name of doing good.

The second source involves criticisms that the IRS and state regulatory agencies have not devoted enough resources to enforcing existing laws governing nonprofit status and

behavior. A recent Stanford University study, for example, faulted the IRS for approving 99% of the applications it receives, including "eccentric" groups like the Red Nose Institute (which sends clown noses to U.S. troops overseas) and the Renegade Rollergirls of Oregon (a nonprofit roller derby league). The theory here is that taxpayers shouldn't be subsidizing, through exemptions and deductions, organizations that provide little if any public value.

No one should condone wrongful conduct. But there's no evidence the kinds of questionable or illegal behavior publicized in congressional hearings and newspaper headlines is widespread—and in any case the smaller charities now in danger of losing their tax exemptions are rarely among the alleged culprits. The smallest charities receive only a tiny share of the benefits of tax exemption. Until now, one reason for not requiring them to submit a Form 990 was to allow the IRS to concentrate its attention on larger charities.

Many smaller charities, faced with new compliance burdens, may choose not to register with the IRS at all. According to research by Indiana University's Kristen A. Gronbjerg, for example, only 60% of Indiana nonprofits are on the IRS rolls. The new rules will hardly make keeping track of them easier.

A larger issue is whether government agencies should expand their apparatus for monitoring charities. Identifying nonprofits that seem to address "eccentric" or even dubious goals has never been hard to do. However, Americans have traditionally believed that encouraging organizations to pursue a multitude of ways of addressing public concerns—including those that the majority of people might deem silly—is essential to preserving the vigorous civil society that makes a healthy democracy possible.

Traditionally, the IRS and state regulators have sought mostly to ensure that charities behave charitably, not to pass judgment on the relative value of their activities. Expanding the requirement to file Form 990 could be consistent with the traditional approach, but it may also portend a more worrisome shift toward greater governmental involvement in the affairs of groups whose value lies in their independence from the state.

Ms. Garment and Mr. Lenkowsky are with the Center on Philanthropy at Indiana University and writing a book on philanthropy and public policy.