

THE ALLIANCE FOR ADVANCING NONPROFIT HEALTH CARE

**SUMMARY AND ANALYSIS OF THE INDEPENDENT SECTOR NONPROFIT
PANEL'S APRIL 2006 SUPPLEMENTAL RECOMMENDATIONS TO**

return of the portfolio as a whole, with diversification generally regarded as an essential component of a prudent investment strategy). The Nonprofit Panel reports that this Act has already been adopted in substantially similar form in more than 40 states and DC.

- Congress should require the IRS to revise section 4944 regulations applicable to private foundations to reflect the above prudent investor standard.

Analysis:

These recommendations appear reasonable, maintaining the state's role as primary overseer and regulator in this area, while ensuring that the prudent standard of care reflects the widespread acceptance of the modern portfolio theory of investment.

Federal Court Equity Powers and Standing to Sue

- Congress should not expand the equity powers or jurisdiction of the U.S. Tax Court over charitable fiduciaries.

Analysis:

This recommendation is reasonable, with suits to enforce charitable duties being brought to state courts primarily by state attorneys general or directors of the nonprofit corporation. The U.S. Tax Court's role should remain limited to reviewing the IRS' determinations of tax exemption and imposition of excise taxes on excess benefits.

Disclosure of Unrelated Business Income

- The IRS should amend Form 990 to require a clear and complete description of a charitable organization's unrelated business activities, with clarifying instructions that all compensation received by an officer, director or key employee from the organization and all of its affiliated entities, including non-cash compensation such as stock options, must be reported if it exceeds a stated threshold.
- The current requirement that private foundation directors and managers report to the IRS any situation where they own 10% or more of an entity in which the foundation also has more than a 10% or more interest should be made applicable to public charities as well.
- The Form 990-T and the tax returns of for-profit entities owned by or affiliated with exempt organization should not be made publicly available.

Analysis:

The first recommendation appears reasonable, assuming that the amendments of Form 990 to provide a "clear and complete" description of unrelated business activities are not overly burdensome. The second recommendation does not appear necessary given the first recommendation. The third recommendation is consistent with the long-standing U.S. tax policy of preserving confidentiality of taxpayers' returns.

Nonprofit Conversions to For-profit

- State charity officials should continue to exercise responsibility for pre-transaction review of proposed charitable conversion transactions.
- States that have not already done so should adopt legislation establishing clear notice, disclosure, and pre-transaction review requirements for all proposed conversion transactions.
- When operating assets of a charity are liquidated in a conversion transaction, as when a nonprofit hospital is sold to a for-profit company, the sales proceeds should be preserved in a charitable organization and used to support appropriate charitable purposes. State legislatures should not divert these charitable assets to fund government or non-charity-related operations.
- The IRS should enforce vigorously the current legal prohibitions against private inurement and substantial private benefits in the context of conversion transactions.

Analysis:

While states have generally delegated the responsibility for review and approval of charitable organization conversion transactions to their attorneys general, some may choose to reserve review and approval of such transactions, especially conversions of large charitable organizations, to the legislature itself. Whatever the state mechanism, it is important that there be, as the Nonprofit Panel recommends, clear requirements for public notice, disclosure, and pre-transaction review. There should also be reasonable opportunities provided for public comment during the pre-transaction review process.

The proceeds of a sale in a conversion transaction should be preserved within the community in a charitable organization, and should be used for purposes that are consistent with the charitable purpose of the organization that was converted. Government should not use the sales proceeds for its own purposes.

The recommendation regarding IRS enforcement is very appropriate, helping to ensure that conversion transactions are not driven by director or manager greed.