HOUSE SELECT COMMITTEE ON

NONPROFITS

REPORT TO THE

1995 GENERAL ASSEMBLY

OF NORTH CAROLINA

1996 REGULAR SESSION

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April 11, 1996

TO THE MEMBERS OF THE 1995 GENERAL ASSEMBLY:

The House Select Committee on Non-Profits submits to you for your consideration its report on ways to increase charitable giving in North Carolina and to reduce and eliminate unnecessary red tape requirements that often plague nonprofits in North Carolina. The report was prepared pursuant to § 3.2(b) of Chapter 542 of the 1995 Session Laws.

Respectfully submitted,

Ed McMahan

Representative Edwin McMahan
Chair, House Select Committee
on Nonprofits

PREFACE

The House Select Committee on Non-Profits was established by PART III, § 3.2(b) of Chapter 542 of the 1995 Session Laws. The Committee consisted of ten members appointed by the Speaker of the House of Representatives: six members of the House of Representatives and four public members. Representative Edwin McMahan was appointed as the chair of the Committee. PART III of Chapter 542 is set out in Appendix A to this report. Appendix B contains a list of the membership and staff of the Committee.

PART III of Chapter 542 instructed the Committee to find ways to facilitate greater cooperation between the public and nonprofit sectors and to foster the growth of the nonprofit sector. In the course of its study, the Committee asked Richard Bostic, a fiscal analyst in the Fiscal Research Division, to summarize and analyze the data from the "Report on Private Organizations Receiving State Funds" produced by the State Auditor. Copies of this final report, the analysis prepared by Richard Bostic, and a Committee notebook containing materials presented to the Committee and minutes of the meetings are on file in the Legislative Library.

COMMITTEE PROCEEDINGS

The House Select Committee on Nonprofits met four times following the adjournment of the 1995 Session of the General Assembly. The Committee proved to be an excellent forum for private citizens, nonprofit representatives, and government officials to discuss the roles and needs of nonprofits in North Carolina. Although the Committee considered many ideas, it did not have the time needed to develop all of them. The Committee recommends in Legislative Proposal 3 that the Legislative Research Commission authorize an additional study of nonprofits. For the purposes of this report, the Committee decided to focus its attention on proposals that could increase charitable giving to 501(c)(3) nonprofits in North Carolina and decrease red tape for the nonprofits that serve North Carolina.

The nonprofit sector in North Carolina is very diverse. It includes small all-volunteer groups like a local PTA to large ones like Duke University and Charlotte's Presbyterian Hospital. Nonprofits work with issues from the arts to the environment, from education to health, from human services to economic development and literacy.

The U.S. Internal Revenue Service has designated 21 different categories of tax-exempt organizations. Appendix A contains a list of these 21 categories of special nonprofit tax exempt organizations. North Carolina has a total of 25,064 organizations that fall into one of these 21 categories. Of these, 14,252 are 501(c)(3) nonprofits, which means their purpose is religious, educational, charitable, scientific, literary, or cultural. Unlike other categories of nonprofits, donations to 501(c)(3) organizations are deductible for income tax purposes.

The Committee's study focused on the 501(c)(3) organizations. Most of these nonprofits in North Carolina are small, all-volunteer organizations. Eighty-six percent of these nonprofits have total annual budgets under $100,000 and half have total budgets under $25,000. Their median annual budgets are about $37,000.

Nonprofits in North Carolina fulfill many different roles. They provide opportunities for religious worship and spiritual growth, deliver services needed in the community, serve as testing ground for solutions to problems, and develop public policy options for government to consider. The theme of the nineties for these nonprofits appears to be: Increasing expectations, decreasing resources. Government budget cuts are expected to create an increase in the demand for nonprofits' services. On the other hand, nonprofits that currently serve as the vehicle for delivering

government-funded programs will likely experience direct cuts in their budgets and all nonprofits will be competing for an increasingly thin pool of private charitable dollars.

The percentage of income that individuals give to nonprofits has remained relatively constant over time. For about a decade, the percentage has been exactly the same -- two percent. The Committee heard two presentations on the question of "Do tax incentives make a difference in charitable giving?" (See Appendices G and H) The answer is yes for federal tax incentives and probably not for state tax incentives because the state tax is so small that it does little to influence individual giving. In the case of sales tax, however, the State's tax can serve as a barrier that discourages giving by merchants. Furthermore, State incentives may affect perceptions, and thus behavior, even if the tax is too small to provide a significant economic incentive.

The Committee considered several tax incentive proposals to increase charitable giving. It is recommending only three of them. The three tax incentive proposals are reflected in Legislative Proposal 1. Part I of this proposal removes a disincentive to give by creating a sales tax exemption for merchant's donations of property to charitable nonprofits. Part II expands the State corporate income tax deduction for charitable contributions to bring it more in line with the federal deduction for charitable contributions. Part III allows a tax credit for charitable contributions made by individuals who do not itemize their deductions. The total estimated cost to the General Fund of Legislative Proposal 1 is $15 million.

The N.C. Nonprofit Corporation Act spells out the laws nonprofits must follow related to their incorporation, bylaws, boards of directors, members, records, liability, and fees. After nonprofits are incorporated and have their bylaws in order, they apply to the IRS for federal tax exemption. Each year, they have to show that they are receiving broad public support and that their activities still fit their charitable purpose. If a nonprofit raises money, it must apply each year for a Charitable Solicitations License and pay a fee to the N.C. Department of Human Resources. Appendix D includes a chart that lists several State and federal laws that govern North Carolina nonprofits.

The Committee recommends two changes to the Charitable Solicitations Act that will reduce government red tape for nonprofits. These recommendations are reflected in Part I of Legislative Proposal 2. The first recommendation contained in Part I modifies the disclosure requirement currently imposed on organizations that solicit contributions to reduce its costs to the nonprofits while maintaining the protection it provides to the public. The required disclosure statement is a phrase notifying the

public that information about the soliciting organization can be obtained through the Department of Human Resources. The second recommendation contained in Part I of Legislative Proposal 2 eliminates duplicate nonprofit reports.

If a nonprofit receives any State funds, it is accountable to the Department of the State Auditor and to the agency that supplies its grant or contract. If a nonprofit receives more than $25,000 in state funds, it must also have a special audit done in addition to its regular independent audit by a CPA. This special audit is an additional expense a nonprofit must bear. The Committee determined that the audit requirement could be modified to reduce costs for smaller nonprofits while enhancing accountability by those who receive State funds. The audit requirement modifications are reflected in Part II of Legislative Proposal 2.

The Committee expresses its appreciation for the assistance of the staff of the N.C. Center for Nonprofits. The Committee also expresses its appreciation to the four public members who served on the Committee at their own expense: Mr. Henry Carter, Mr. Ed Ellis, Mr. William Spencer, and Mr. Paul Stam. Finally, the Committee thanks the representatives of the Internal Revenue Service who provided a detailed, informative presentation and materials on federal regulation of tax-exempt entities. The Committee's task was made easier by the informed comments and suggestions of these individuals.

COMMITTEE RECOMMENDATIONS AND LEGISLATIVE PROPOSALS

The House Select Committee on Nonprofits recommends the following legislation to the 1996 Session of the 1995 General Assembly. The Committee's legislative proposals consist of two bills and a resolution. Each proposal is followed by an explanation. Legislative Proposal 1 is followed by a fiscal note indicating the anticipated revenue loss resulting from the proposal.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1995

H D

LEGISLATIVE PROPOSAL 1
96-NPRB-100

Short Title: Incentives to Increase Charitable Giving. (Public)

Sponsors: House Select Committee on Nonprofits.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO INCREASE GIVING TO CHARITABLE NONPROFIT ORGANIZATIONS BY EXEMPTING FROM SALES AND USE TAX TANGIBLE PERSONAL PROPERTY THAT IS MANUFACTURED OR PURCHASED FOR RESALE BY A WHOLESALE MERCHANT OR A RETAILER AND THEN DONATED TO A CHARITABLE NONPROFIT ORGANIZATION, BY EXPANDING THE STATE CORPORATE INCOME TAX DEDUCTION FOR CHARITABLE CONTRIBUTIONS, AND BY PROVIDING AN INCOME TAX CREDIT FOR CERTAIN CHARITABLE CONTRIBUTIONS BY INDIVIDUALS WHO CANNOT DEDUCT THE CONTRIBUTIONS BECAUSE THEY DO NOT ITEMIZE.

The General Assembly of North Carolina enacts:

PART I. SALES TAX

Section 1.1. G.S. 105-164.13 is amended by adding a new subdivision to read:

"(42) Tangible personal property that is purchased by a retailer for resale or is manufactured or purchased by a wholesale merchant for resale and then withdrawn from inventory and donated by the retailer or wholesale merchant to a nonprofit organization, contributions to which are deductible as charitable contributions for federal income tax purposes."

Sec. 1.2. G.S. 105-164.13 (13a) and (31b) are repealed.

PART II. CORPORATE INCOME TAX

Sec. 2.1. G. S. 105-130.9 reads as rewritten:

"**§ 105-130.9. Contributions.**

~~Contributions shall be allowed as a deduction to the extent and in the manner provided as follows:~~ (a) North Carolina Corporations. -- Corporations that do not allocate a part of their total net income outside this State may deduct the following contributions to the extent allowed in this section:

(1) Most Charitable Contributions. -- Charitable contributions as defined in section 170(c) of the Code, ~~exclusive of~~ other than contributions allowed in subdivision (2) of this section, shall be allowed as a deduction to the extent provided ~~herein.~~ in this section. The amount allowed as a deduction ~~hereunder shall be limited to an amount not in excess of five percent (5%)~~ may not exceed ten percent (10%) of the corporation's net income as computed without the benefit of this subdivision or subdivision (2) of this section. ~~Provided, that a carryover of contributions shall not be allowed and that contributions made to North Carolina donees by corporations allocating a part of their total net income outside this State shall not be allowed under this subdivision, but shall be allowed under subdivision (3) of this section.~~

(2) Contributions to North Carolina Governments and Educational Institutions. -- Contributions ~~by any corporation~~ to the following entities shall be allowed as a deduction: the State of North Carolina, any of its institutions, instrumentalities, or agencies, any county of this State, its institutions, instrumentalities, or agencies, any municipality of this State, its institutions, instrumentalities, or agencies, and ~~contributions or gifts by any corporation to~~ any educational institutions located within North Carolina, no part of the net earnings of which inures to the benefit of any private stockholders or dividend. For the purpose of this subdivision, the ~~words~~ term 'educational institution' ~~shall mean~~ includes only an educational institution ~~which~~ that normally maintains a regular faculty and curriculum and normally has a regularly organized body of students in attendance at the place where the

educational activities are carried on. The ~~words "educational institution" shall be deemed to include all of such~~ term includes all of the institution's departments, ~~schools~~ schools, and colleges, a group of ~~"educational institutions"~~ educational institutions, and an organization ~~(corporation, trust, foundation, association or other entity)~~ organized and operated exclusively to receive, hold, ~~invest~~ invest, and administer property and to make expenditures to or for the sole benefit of an ~~"educational institution" or group of "educational institutions."~~ educational institution.

~~(3)~~

(b) Interstate Corporations. -- Corporations allocating a part of their total net income outside North Carolina under ~~the provisions of~~ G.S. 105-130.4 ~~shall~~ may deduct from total income allocable to North Carolina contributions made to North Carolina donees qualified under ~~subdivisions (1) and (2) of this section~~ subdivision (1) or (2) of subsection (a) or made through North Carolina offices or branches of other donees qualified under ~~the above-mentioned~~ those ~~subdivisions of this section; provided, such~~ subdivisions. The deduction for contributions made to North Carolina donees qualified under subdivision (1) of this section ~~shall be limited in amount to five percent (5%)~~ may not exceed ten percent (10%) of the total income allocated to North Carolina as computed without the benefit of this ~~deduction for contributions.~~ subsection.

Corporations allocating a part of their total net income outside North Carolina may deduct from net income before allocation under G.S. 105-130.4 contributions made to other donees qualified under subdivision (1) of subsection (a). This deduction may not exceed ten percent (10%) of the corporation's net income before allocation under G.S. 105-130.4. as computed without the benefit of this subsection.

(c) Carryforward. -- If a corporation's deductions allowed under subdivision (a)(1) or subsection (b) of this section exceed the applicable percentage limitation, the corporation may carry the excess forward for the succeeding five years to the extent the amounts carried forward under this subsection plus the amounts deductible under subdivision (a)(1) or subsection (b) of this section for each taxable year do not exceed the percentage limitation for that taxable year. Amounts deductible under subdivision (a)(1) or subsection (b) of this section for the

current taxable year shall be taken into account before amounts carried forward under this subsection.

~~(4)~~ ~~The~~

(d) Double Benefit Disallowed. -- The amount of a contribution for which the taxpayer claimed a tax credit pursuant to G.S. 105-130.34 shall not be eligible for a deduction under this section. The amount of the credit claimed with respect to the contribution is not, however, required to be added to income under G.S. 105-130.5(a)(10)."

Sec. 2.2. G.S. 105-130.5(b)(5) reads as rewritten:

"(5) Contributions or gifts made by any corporation ~~within the income year~~ to the extent provided under G.S. 105-130.9."

PART III. INDIVIDUAL INCOME TAX.

Sec. 3.1. Division II of Article 4 of Chapter 105 of the General Statutes is amended by adding a new section to read:

"**§ 105-151.26. Credit for charitable contributions by nonitemizers.**

A taxpayer who elects the standard deduction under section 63 of the Code for federal tax purposes is allowed as a credit against the tax imposed by this Division an amount equal to seven percent (7%) of the taxpayer's excess charitable contributions. The taxpayer's excess charitable contributions are the amount by which the taxpayer's charitable contributions for the taxable year that would have been deductible under section 170 of the Code if the taxpayer had not elected the standard deduction exceed two percent (2%) of the taxpayer's adjusted gross income as calculated under the Code.

No credit shall be allowed under this section for amounts deducted from gross income in calculating taxable income under the Code or for contributions for which a credit was claimed under G.S. 105-151.12 or G.S. 105-151.14. A nonresident or part-year resident who claims the credit allowed by this section shall reduce the amount of the credit by multiplying it by the fraction calculated under G.S. 105-134.5(b) or (c), as appropriate. The credit allowed under this section may not exceed the amount of tax imposed by this Division for the taxable year reduced by the sum of all credits allowed, except payments of tax made by or on behalf of the taxpayer. "

PART IV. EFFECTIVE DATES

Sec. 4.1. Parts II and III of this act are effective for taxable years beginning on or after January 1, 1996. The remainder of this act is effective upon ratification.

Explanation - Incentives to Increase Charitable Giving

Legislative Proposal 1 reflects the House Select Committee on Nonprofits' three recommendations to increase charitable giving by businesses and individuals. The first part of the bill removes a disincentive for businesses to give by creating a new sales and use tax exemption for tangible personal property that is donated to a charitable nonprofit organization by a retailer or a wholesale merchant. Part II of the bill expands the State corporate income tax deduction for charitable contributions in two ways and brings it more in line with the federal deduction for charitable contributions. Part III of the bill creates a tax credit for charitable contributions made by individuals who do not itemize their deductions. The estimated cost of this proposal is $15 million.

PART I. No Sales Tax on Donated Items.

Under current law, medicine and certain food donated to a charitable nonprofit organization are exempt from sales and use tax. Part I of this bill would expand the current law by creating a new sales and use tax exemption for tangible personal property that is donated to a charitable nonprofit organization by a retailer or a wholesale merchant. It would repeal the current two exemptions since they become redundant in light of the new, and broader, exemption created by the bill. This part of the bill would become effective upon ratification and its estimated annual loss is $600,000.

Under current law, a wholesale merchant or retailer who donates products to a nonprofit organization instead of selling them is liable for the sales and use tax. A wholesale merchant or retailer does not pay sales or use taxes when purchasing the products or the ingredients used to manufacture the products because the products are to be resold. Sales and use taxes do not apply to property purchased for resale or ingredients purchased to manufacture products for resale. If the wholesale merchant or retailer chooses not to sell the goods, the wholesale merchant or retailer becomes liable for use tax on the goods because the resale exemption no longer applies. This is true no matter what the company chooses to do with the products. Section 1.1 eliminates this liability for use tax by providing a specific exemption for tangible personal property purchased or manufactured by a wholesale merchant or retailer for resale and

then withdrawn from inventory and donated to a nonprofit organization, contributions to which are deductible as charitable contributions for federal income tax purposes.

The General Assembly enacted a law exempting food that is acquired at wholesale and then donated to a nonprofit organization in 1992. That year, it also enacted a law exempting from sales and use tax prescription and nonprescription drugs donated to a nonprofit organization. Section 1.2 repeals these two exemptions because they are part of the more inclusive exemptions created in section 1 of the bill.

PART II. Expand Corporate Charitable Deduction.

This part of the proposal would expand the State income tax deduction for charitable contributions in two ways and bring it more in line with the federal deduction for charitable contributions. This part of the bill would become effective beginning with the 1996 tax year.

North Carolina caps corporate contributions to most charitable entities at an amount equal to 5% of the corporation's North Carolina taxable income. The federal cap is 10% of the corporation's taxable income. This bill would change the North Carolina cap from 5% to 10%. Contributions to the following entities are not subject to any cap in North Carolina: the State of North Carolina, any of its agencies or political subdivisions, and any North Carolina nonprofit educational institution. The bill does not change the current law with regard to these entities; deductions for contributions will still be unlimited.

If a corporation's contributions exceed the 5% cap, North Carolina does not allow the corporation to carry the excess forward and deduct it in a future year. Under federal law, if a corporation's contributions exceed the 10% cap, they may be carried forward and deducted in the next five tax years. This bill would allow a five-year carryforward for deductions subject to the cap that exceed the cap.

The increase in the cap from 5% to 10% is expected to cause a General Fund revenue loss of between $2.5 and $3.5 million a year. The allowance of carryforwards would add to this loss an additional annual loss of between $600,000 and $900,000. These numbers are estimates based upon limited data available.

PART III. Nonitemizers Tax Incentive.

This part of the proposal would allow a tax credit for charitable contributions made by individuals who do not itemize their deductions. This part of the bill would become effective beginning with the 1996 tax year.

Under the federal Internal Revenue Code, an individual who itemizes deductions may deduct contributions to nonprofit charitable organizations. Individuals who elect the standard deduction, however, may not deduct charitable contributions. An individual's North Carolina's income tax is based on the federal calculation of taxable income, with some adjustments. The federal disallowance of charitable deductions for nonitemizers is "piggybacked" by North Carolina tax law, so there is no income tax incentive under federal or North Carolina law for nonitemizers to make charitable contributions. Legislation has been introduced in Congress to allow nonitemizers to deduct charitable contributions. If this federal legislation (HR 1493) were enacted, North Carolina could "piggyback" the federal tax incentive. HR 1493 is not expected to pass, however.

Individuals who elect the standard deduction are those whose total itemized deductions (such as mortgage interest, State and local property and income taxes, medical expenses, and charitable contributions) do not exceed the standard deduction amount. The standard deduction amounts for 1996 are $6,700 for a married couple filing a joint return and $4,000 for a single individual.

This bill would allow a North Carolina tax credit equal to 7% of a nonitemizer's charitable contributions that exceed 2% of the taxpayer's adjusted gross income. A tax credit is a dollar-for-dollar subtraction from tax rather than a subtraction from taxable income. Thus, if a taxpayer pays tax at the 7% rate, a 7% tax credit is equal to a full deduction. North Carolina's tax rates are 6%, 7%, and 7.75%.

Fiscal Report
Fiscal Research Division
April 25, 1996

Proposal # 1:

Fiscal Effect:

PART 1

No Sales Tax on Donated Items

Since 1992, medicine and food donated by a retailer or a wholesale merchant to a non-profit organization to be used for a charitable purpose have been exempt from sales and use tax. The Revenue Laws Study Committee proposed a bill to the 1995 General Assembly to broaden the tax exemption for donated goods to include all tangible personal property. Senate Bill 103 introduced by Senator Cochrane in the 1995 Session was approved by the Senate Finance Committee, but was held by Senate Appropriations.

Like Senate Bill 103, Part 1 of the bill exempts from sales and use tax all tangible personal property a business donates to a non-profit organization to be used for a charitable purpose. The current provision for donated food and medicine is no longer needed and thus repealed. The Department of Revenue estimates an annual $600,000 loss to the General Fund due to this exemption from the sales and use tax.

PART 2

Expand Corporate Charitable Deduction

Part 2 of the bill conforms the state corporate income tax deduction for charitable contributions to the federal code effective for taxable years beginning on or after January 1, 1996. First, it raises the cap on corporate contributions from 5% to 10% of a corporation's taxable income. Second, it allows the corporation to carry forward for five years any contributions that exceed the 10% cap.

The Tax Research Division of the Department of Revenue estimates the General Fund revenue lost due to this provision will range from $3.1 million to $4.4 million. The estimate was based on 1990 corporate income tax returns in which 24% of the returns had contributions exceeding 5% of their North Carolina net income. The data was projected to 1996 tax year.

PART 3

Non-Itemized Tax Incentive

Part 3 of the bill will allow a taxpayer who chooses the standard deduction on the North Carolina individual income tax return to receive a tax credit equal to 7% of the charitable contributions that exceed 2% of the taxpayer's adjusted gross income. This section is effective for taxable years beginning on or after January 1, 1996.

The Fiscal Research Division estimates that this credit will produce a revenue loss to the General Fund of $12.5 million annually based on current giving patterns. For every 5% increase in charitable giving prompted by this credit, an additional $2 million in state revenues will be lost. These estimates are based on charitable giving rates for non-itemizers provided by the Independent Sector, a non-profit coalition of over 800 corporate, foundation and voluntary organization members. The number of non-itemizers in North Carolina is based on estimates from the Department of Revenue's personal income tax model.

SUMMARY

In sum, the proposed bill will reduce General Fund revenues an estimated $16.2 million to $17.5 million annually.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1995

H **D**

LEGISLATIVE PROPOSAL 2
96-NPRB-200
(THIS IS A DRAFT AND NOT READY FOR INTRODUCTION)

Short Title: Nonprofits Disclosure/Accountability. (Public)

Sponsors: House Nonprofits Study Commission.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO MODIFY THE REQUIRED DISCLOSURE STATEMENT AND ELIMINATE DUPLICATIVE REPORTING REQUIREMENTS UNDER THE CHARITABLE SOLICITATIONS ACT AND TO MODIFY AND CLARIFY REQUIREMENTS FOR NON-GOVERNMENTAL ENTITIES' ACCOUNTABILITY FOR STATE GRANTS.

The General Assembly of North Carolina enacts:

PART I. AMEND CHARITABLE SOLICITATIONS ACT

Section 1.1. G.S. 131F-9(c) reads as rewritten:

"(c) Printed Disclosure. -- Every charitable organization or sponsor that is required to obtain a license under G.S. 131F-5 shall conspicuously display in ~~capital letters in bold~~ type of a minimum size ~~10~~ nine points, the following statement on every printed solicitation, written confirmation, receipt, or reminder of a contribution:

~~'A COPY OF THE LICENSE TO SOLICIT CHARITABLE CONTRIBUTIONS AS A CHARITABLE ORGANIZATION OR SPONSOR AND FINANCIAL INFORMATION MAY BE OBTAINED FROM THE DEPARTMENT OF HUMAN RESOURCES, SOLICITATION LICENSING BRANCH, BY CALLING (919) 733-4510. REGISTRATION DOES NOT IMPLY ENDORSEMENT, APPROVAL, OR RECOMMENDATION BY THE STATE.'~~ 'Financial information about this organization and a copy of its license are available from the State Solicitation Licensing Branch at [telephone number]. The license is not an endorsement by the State.'

The statement shall be made conspicuous by use of one or more of the following: underlining, a border, or bold type. When the solicitation consists of more than one piece, the statement shall be displayed prominently in the solicitation materials, but not necessarily on every page."

Sec. 1.2. G.S. 131F-17(a)(3) reads as rewritten:

"(3) In addition to the information required by subdivision (1) of this subsection, any written confirmation, receipt, or reminder of contribution made pursuant to an oral solicitation and any written solicitation shall conspicuously state in ~~capital letters in bold~~ type of a minimum of ~~10~~ nine points:

~~"A COPY OF THE LICENSE AND FINANCIAL INFORMATION OF THE SOLICITOR MAY BE OBTAINED FROM THE DEPARTMENT OF HUMAN RESOURCES, SOLICITATION LICENSING BRANCH, BY CALLING (919) 733-4510. REGISTRATION DOES NOT IMPLY ENDORSEMENT, APPROVAL, OR RECOMMENDATION BY THE STATE."~~

'Financial information about the solicitor and a copy of its license are available from the State Solicitation Licensing Branch at [telephone number]. The license is not an endorsement by the State.'

The statement shall be made conspicuous by use of one or more of the following: underlining, a border, or bold type. When the solicitation materials consist of more than one piece, the statement shall be displayed prominently in the solicitation materials, but not necessarily on every page."

Sec. 1.3. G.S. 131F-6 reads as rewritten:

"§ 131F-6. Information required for licensure.

(a) Initial Information Required. -- The initial application for a license for a charitable organization or sponsor shall be submitted on a form provided by the Department, signed under oath by the treasurer or chief fiscal officer of the charitable organization or sponsor, and shall include the following:

(1) The name of the charitable organization or sponsor, the purpose for which it is organized, the name under which it intends to solicit contributions, and the purpose for which the contributions to be solicited will be used.

(2) The principal street address and telephone number of the charitable organization or sponsor and the street address and telephone numbers of any offices in this State or, if the charitable organization or sponsor does not maintain an office in this State, the name, street address, and telephone number of the person who has custody of its financial records. The parent organization that files a consolidated registration statement under G.S. 131F-7 on behalf of its chapters, branches, or affiliates shall additionally provide the street addresses and telephone numbers of all of its locations in this State.

(3) The names and street addresses of the officers, directors, trustees, and the salaried executive personnel.

(4) The date when the charitable organization's or sponsor's fiscal year ends.

(5) A list or description of the major program activities.

(6) The names, street addresses, and telephone numbers of the individuals or officers who have final responsibility for the custody of the contributions and who will be responsible for the final distribution of the contributions.

(7) The name of the individuals or officers who are in charge of any solicitation activities.

(8) A financial report for the immediately preceding fiscal year upon a form provided by the Department. The report shall include the following:
a. The balance sheet.
b. A statement of support, revenue, and expenses, and any change in the fund balance.
~~c. The names and addresses of any fund-raising consultant, solicitor, and coventurer used, if any, and the amounts received from each of them, if any.~~
d. A statement of expenses in the following categories:
1. Program.
2. Management and general.
3. Fund-raising.

(9) In substitution for the ~~financial report~~ <u>information</u> described in ~~subdivision (8)~~

subdivisions (3), (4), (5), (6), and (8) of this subsection, a charitable organization or sponsor may ~~submit~~ submit, at the time the application is filed, a copy of its Internal Revenue Service Form 990 and Schedule A filed for the preceding fiscal year, or a copy of its Form 990-EZ filed for the preceding fiscal year.

(10) A charitable organization or sponsor may include a financial report which has been audited by an independent certified public accountant or an audit with opinion by an independent certified public accountant. In the event that a charitable organization or sponsor elects to file this, this optional filing shall be noted in the Department's annual report submitted under G.S. 131F-30.

(11) A newly organized charitable organization or sponsor with no financial history shall file a budget for the current fiscal year.

(12) A statement indicating all of the following:

a. Whether or not the charitable organization or sponsor is authorized by any other state to solicit contributions.

b. Whether or not the charitable organization or sponsor or any of its officers, directors, trustees, or salaried executive personnel have been enjoined in any jurisdiction from soliciting contributions or have been found to have engaged in unlawful practices in the solicitation of contributions or administration of charitable assets.

c. Whether or not the charitable organization or sponsor has had its authority denied, suspended, or revoked by any governmental agency, together with the reasons for the denial, suspension, or revocation.

d. Whether or not the charitable organization or sponsor has voluntarily entered into an assurance of voluntary compliance or agreement similar to that set forth in G.S. 131F-24(c), together with a copy of that agreement.

(13) The names, street addresses, and telephone numbers of any solicitor, fund-raising consultant, or coventurer who is acting or has agreed to act on behalf of the charitable organization or sponsor,

together with a statement setting forth the specific terms of the arrangements for salaries, bonuses, commissions, expenses, or other compensation to be paid the fund-raising consultant, solicitor, or ~~coventurer.~~ coventurer, and the amounts received from each of them, if any.

(14) With initial licensing only, when and where the organization was established, the tax-exempt status of the organization, and a copy of any federal tax exemption determination letter. If the charitable organization or sponsor has not received a federal tax exemption determination letter at the time of initial licensing, a copy of the determination shall be filed with the Department within 30 days after receipt of the determination by the charitable organization or sponsor. If the organization is subsequently notified by the Internal Revenue Service of any challenge to its continued entitlement to federal tax exemption, the charitable organization or sponsor shall notify the Department of this fact within 30 days after receipt.

(b) Renewal Information Required. -- A license shall be renewed on an annual basis. The charitable organization or sponsor shall submit any changes in the information submitted from the initial application."

PART II. NONPROFITS/STATE FUNDS ACCOUNTABILITY

Sec. 2.1. G.S. 143-6.1 reads as rewritten:

"**§ 143-6.1. ~~Information from private organizations receiving State funds; information from State departments and agencies providing State funds.~~ Reports on use of State funds by non-State entities.**

(a) Disbursement and Use of State Funds. -- Every corporation, organization, and institution ~~which receives, uses~~ that receives, uses, or expends any State funds shall use or expend ~~such~~ the funds only for the purposes for which ~~such State funds~~ they were appropriated by the General Assembly or collected by the State. State funds include federal funds that flow through the State. For the purposes of this section, the term 'grantee' means a corporation, organization, or institution that receives, uses, or expends any State funds. The State may not disburse State funds appropriated by the General Assembly or collected by the State for use by any grantee unless that grantee has provided all the reports and financial information required by this section. When

disbursing funds to a grantee, a State agency shall notify the grantee whether the funds are for the purchase of goods and services and whether the funds are subject to federal reporting requirements. All financial statements furnished to the State Auditor pursuant to this section, and any audits or other reports prepared by the State Auditor, are public records.

(b) State Agency Reports. -- A State agency that receives State funds and then disburses the State funds to a grantee must identify the grantee to the State Auditor, unless the funds were for the purchase of goods and services. The State agency must submit documents to the State Auditor in a prescribed format describing standards of compliance and suggested audit procedures sufficient to give adequate direction to independent auditors performing audits.

(c) Grantee Receipt and Expenditure Reports. -- A grantee that receives, uses, or expends between fifteen thousand dollars ($15,000) and one hundred thousand dollars ($100,000) in State funds annually, except when the funds are for the purchase of goods or services, must file annually with the State agency that disbursed the funds a sworn accounting of receipts and expenditures of the State funds. This accounting must be attested to by the treasurer of the grantee and one other authorizing officer of the grantee. The accounting must be filed within six months after the end of the grantee's fiscal year in which the State funds were received. The accounting shall be in the form required by the disbursing agency. Each State agency shall develop a format for these accountings and shall obtain the State Auditor's approval of the format.

(d) Grantee Audit Reports. -- A grantee that receives, uses, or expends State funds in the amount of one hundred thousand dollars ($100,000) or more annually, except when the funds are for the purchase of goods or services, must file annually with the State Auditor a financial statement in the form and on the schedule prescribed by the State Auditor. The financial statement must be audited in accordance with standards prescribed by the State Auditor to assure that State funds are used for the purposes provided by law.

(e) Federal Reporting Requirements. -- Federal law may require a grantee to make additional reports with respect to funds for which reports are required under this section. Notwithstanding the provisions of this section, a grantee may satisfy the reporting requirements of subsection (c) of this section by submitting a copy of the report required under federal law with

respect to the same funds or by submitting a copy of the report described in subsection (d) of this section.

(f) Audit Oversight. -- The State Auditor has audit oversight, pursuant to Article 5A of Chapter 147 of the General Statutes, of every grantee that receives, uses, or expends State funds. Such a grantee must, upon request, furnish to the State Auditor for audit all books, records, and other information necessary for the State Auditor to account fully for the use and expenditure of State funds. The grantee must furnish any additional financial or budgetary information requested by the State Auditor.

~~Each corporation, organization, and institution which receives, uses or expends State funds in the amount of twenty-five thousand dollars ($25,000) or more annually, except when the funds are for the purchase of goods or services, shall file annually with the State Auditor and with the Joint Legislative Commission on Governmental Operations financial statements for that year in which twenty-five thousand dollars ($25,000) or more in State funds were received, used, or expended. These financial statements shall be audited in accordance with the auditing standards prescribed by the State Auditor, and the audit report shall be received by the State Auditor within six months after the end of the private organization's year in which twenty-five thousand dollars ($25,000) or more were received, used, or expended. Each corporation, organization, and institution shall furnish to the State Auditor for audit all books, records and other information as shall be necessary for the State Auditor to account fully for the use and expenditure of State funds. Each such corporation, organization, and institution shall furnish such additional financial or budgetary information as shall be requested by the State Auditor or by the Joint Legislative Commission on Governmental Operations. The State shall not disburse State funds appropriated by the General Assembly or collected by the State for use by any corporation, organization, or institution until that corporation, organization, or institution has provided all the reports and financial information required by this section. All financial statements furnished to the State Auditor or to the Joint Legislative Commission on Governmental Operations pursuant to this section, and any audits or other reports prepared by the State Auditor, shall be public records.~~

~~Each State department and agency shall identify to the State Auditor each corporation, organization, and institution to which State funds received by the department or agency have been provided, except for the purchase of goods and services, and~~

~~submit documents to the State Auditor for approval in a prescribed format describing standards of compliance and suggested audit procedures sufficient to give adequate direction to independent auditors performing audits.~~

~~The receipt, use or expenditure of State funds by a corporation, organization, and institution shall not, in and of itself, make or constitute such corporation, organization, or institution a State agency.~~"

Sec. 2.2. Section 11 of Chapter 324 of the 1995 Session Laws is repealed.

PART III. EFFECTIVE DATES

Sec. 3.1. Section 1.3 of Part I and Part II of this act become effective July 1, 1996. The remainder of this act is effective upon ratification. Effective until January 1, 1998, a document that complies with the requirements of G.S. 131F-9(c) or G.S. 131F-17(a)(3) as in effect before ratification of this act shall be considered to comply with the requirements of the respective statute as amended by this act.

Explanation - Nonprofits Disclosure/Accountability

Legislative Proposal 2 reflects the House Select Committee on Nonprofits' proposals to reduce government red tape for nonprofits. Part I of the proposal makes two changes to the Charitable Solicitations Act. Sections 1.1 and 1.2 of the bill would modify the disclosure requirements currently imposed on organizations that solicit contributions. Section 1.3 of the bill would eliminate duplicative reporting requirements. Part II of the bill would modify the audit requirements for nonprofits receiving State funds to reduce the audit costs for the nonprofits while enhancing accountability to the State. Part III of the bill provides the effective dates.

PART I. Amend Charitable Solicitations Act.

The Charitable Solicitations Act currently requires charitable organizations and sponsors, and those who solicit contributions on their behalf, to print on their documents a phrase notifying the public that information about the soliciting organization can be obtained through the Department of Human Resources. Printing this notification has proven costly for nonprofit organizations. Sections 1.1 and 1.2 of the bill make the following changes to reduce nonprofits' costs while maintaining the protection provided by the disclosure:

1. The wording of the disclosure statement is made more concise, reducing the number of words from 44 to 30.
2. The statement does not have to be in all capital letters. All capital letters are actually harder to read.
3. The statement can be any of the following: in bold type, underlined, or surrounded by a border. Currently, it must be bold.
4. The minimum type size is reduced from 10 points to 9 points.

The Charitable Solicitations Act lists the information a charitable organization or sponsor must provide to be licensed. Some of the information is also provided in an organization's Internal Revenue Service form 990. Section 1.3 of the bill would simplify licensing for nonprofits by allowing them to submit a form 990, at the time the application is filed, in substitution for several categories of information required in an application for licensing under the Charitable Solicitations Act. That Section also requires that information about how much money a solicitor has raised for the organization or sponsor must be provided with the application, whether or not a form 990 is also submitted. These changes become effective July 1, 1996.

PART II. Nonprofits - State Funds Accountability.

G.S. 143-6.1 requires all corporations, organizations, and institutions that receive $25,000 or more in State funds a year (other than for goods and services) to file audited financial statements annually with the Joint Legislative Commission on Governmental Operations and with the State Auditor. This requirement was enacted as part of the budget bill in 1989. The 1995 budget bill provided that entities receiving domestic violence grants must comply with this audit requirement no matter what size their grant is.

G.S. 143-6.1 also requires every State agency that provides State funds in any amount to these entities (other than for goods and services) to submit to the State Auditor reports on the entities describing standards of compliance and suggested audit procedures. This requirement was enacted as part of the budget bill in 1991. The resolution of audit findings is the responsibility of the funding agency.

The apparent intent of these requirements is to assure that State funds are spent only for the purpose for which they were appropriated. The term "State funds" includes federal funds that flow through the State. Requiring the recipients of State funds to pay for their own private audits is considered more efficient than creating a government program in which State auditors would audit each recipient.

The statute provides that the State Auditor will prescribe standards for the audited financial statements that must be filed. In accordance with this authority, and based on the statute's apparent intent to assure that State funds are spent for the purpose for which they were appropriated, the State Auditor has prescribed that the financial statements must be prepared in accordance with generally accepted accounting principles (GAAP) and audited in accordance with Government Auditing Standards developed by the Comptroller General of the United States. This latter requirement is known as a "yellow book audit," which, unlike a financial statement audit, reports and gives an opinion on compliance with rules and regulations. The Auditor allows the grantee to choose between an entity-wide audit or a program audit if there is only one program and it involves less than $100,000. The federal law allows the same option.

More than 1,800 entities currently receive State funds (including federal funds that flow through the State). More than 600 entities receive $25,000 or more and are thus subject to the audit requirement. Representatives of nonprofit agencies informed the Committee that the audit requirement creates a significant hardship on smaller nonprofit agencies. It is often difficult to find Certified Public Accountants who will

perform the yellow book audit (as opposed to a financial statement audit) and those who will may charge as much as 30% - 66% more for a yellow book audit than for a financial statement audit. For grants in the $25,000 - $50,000 range, the cost of the audit can be 5% to 15% of the amount of the grant. In most cases, the State grant funds cannot be used to pay for the audit, so some smaller nonprofits have to decline grants because they cannot afford to pay for the audit.

The Committee recognized the paramount importance of having a mechanism to assure that State funds are spent only as provided by law. The Committee learned, however, that adequate assurance may be maintained through other mechanisms that are less burdensome and costly for small nonprofits. First, the Committee learned from staff of the Joint Legislative Commission on Governmental Operations that it was not necessary for an extra copy of each audit to be filed with that Commission as long as the State Auditor's Office reports to Governmental Operations on issues and problems raised by the audits it receives. Copies filed with the funding agency and with the State Auditor are sufficient to support government oversight responsibilities.

Second, the Committee learned that an audit serves not so much to detect fraud as to provide a deterrent to fraud and abuse. Fraud is more often detected through investigations, which may arise from tips received by the State Auditor's Fraud, Waste, and Abuse (Hotline) section. The deterrent effect comes from requiring the grantee to file a report that will be reviewed by someone other than the individual who, otherwise, might misuse the funds. To some extent, this deterrent purpose could be accomplished by requiring grantees to file, instead of audits, sworn accountings of all receipts and expenditures of State funds. These statements would have to be verified by two individuals within the entity: the treasurer and another authorizing officer. Requiring two individuals to verify or execute actions independently of one another is a recognized method of deterring misconduct, and is seen in common requirements that checks bear two signatures before they can be honored.

Third, the Committee determined that the $25,000 threshold may be too low for the yellow book audit requirement. Nonprofits receiving smaller grants have the hardest time paying for the more expensive yellow book audit. With smaller entities, less State money is at risk, so the cost of monitoring may outweigh the benefit the State would receive, and the entity may have to decline the grant. Eighty-six percent of nonprofits have total annual budgets of $100,000 or less. Based on 1993 data, 75% to 80% of State funds granted to nongovernmental entities went to entities receiving $100,000 or more of State funds. These entities represent only about 30% of the

entities receiving State funds; the remaining 70% received only 20% to 25% of the State funds, in amounts less than $100,000. Thus, most State grant funds would still be audited if the audit threshold were raised, but many smaller entities would no longer be subject to the audit requirement.

Fourth, the Committee considered whether, for smaller grants, a financial statement audit could be substituted for the more expensive yellow book audit. The Committee determined that a financial statement audit usually would not provide information about whether State funds have been used for the purpose for which they were appropriated. This information could be provided, however, by an accounting of expenditures and receipts of State funds. This accounting would allow the funding agency to identify and resolve problems as part of its grants management program and to measure results against expenditures. Such a requirement could also enhance the State's ability to monitor the use of its funds by nongovernmental entities if it were extended to all entities receiving $15,000 or more, rather than just those receiving $25,000 or more a year. Because this accounting requirement should be less expensive than an audit, extending it to cover smaller grants should not create a hardship for nonprofits.

For these reasons, the Committee decided to recommend that the requirements of G.S. 143-6.1 be modified as follows:

(1) The requirement that an extra copy of the audit be filed with the Joint Legislative Commission on Governmental Operations is eliminated. This change should provide a small cost savings to nonprofits.

(2) The requirement of a yellow book audit is limited to those entities receiving $100,000 or more in State funds, including federal funds that flow through the State. Roughly 75% to 80% of State funds going to nongovernmental entities would be covered by the yellow book audit requirement.

(3) All nongovernmental entities that receive between $15,000 and $100,000 in State funds are required to file with the funding agency an accounting of receipts and expenditures, attested to by the entity's treasurer and another authorizing officer of the entity. Lowering the threshold from $25,000 to $15,000 increases the number of entities being held accountable. The accounting will enable the funding agency to monitor use of the funds as part of its grants management program. Because it can be performed in house, this accounting should be less expensive than an audit.

(4) The special rules for domestic violence centers are removed so that these centers will be subject to the same requirements as all other entities. A study is currently being conducted on consolidating the administration of federal and State grants to domestic violence centers, pursuant to Chapter 507 of the 1995 Session Laws.

(5) Funding agencies must specify to recipients of funds whether the funds are grants, which are subject to the requirements of G.S. 143-6.1, or payments for goods or services, which are subject to the State's accounts management system administered by the State Controller.

These changes are set out in Part II of Legislative Proposal Two, which also reorganizes and modernizes the language of G.S. 143-6.1. The proposal would become effective July 1, 1996. The Committee noted that the language of the statute describing the entities to which it applies is ambiguous. The language appears to cover local government agencies although they are subject to separate reporting requirements under the Local Government Budget and Fiscal Control Act, Article 3 of Chapter 159 of the General Statutes. The Committee requested that staff explore the issue of clarifying this language at a future date.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1995

H **D**

LEGISLATIVE PROPOSAL 3
HOUSE JOINT RESOLUTION 95-NPRB-5
(THIS IS A DRAFT AND NOT READY FOR INTRODUCTION)

Sponsors: House Select Committee on Nonprofits.

Referred to:

A JOINT RESOLUTION AUTHORIZING THE LEGISLATIVE RESEARCH COMMISSION TO STUDY WAYS TO FACILITATE GREATER COOPERATION BETWEEN THE PUBLIC AND NONPROFIT SECTORS AND TO FOSTER THE GROWTH OF THE NONPROFIT SECTOR.

Whereas, the House Select Committee on Nonprofits was authorized to study issues relating to the facilitation of greater cooperation between the public and nonprofit sectors and the fostering of growth of the nonprofit sector; and

Whereas, the Committee will report its findings and recommendations to the 1996 Regular Session of the 1995 General Assembly; and

Whereas, the Committee has found the issues involved in this matter to be so important as to merit additional study by the Legislative Research Commission;

Now, therefore, be it resolved by the House of Representatives, the Senate concurring:

Section 1. The Legislative Research Commission is authorized to study ways to facilitate greater cooperation between the public and nonprofit sectors and to foster the growth of the nonprofit sector. The study should include an analysis of the procedures currently used to contract between State agencies and nonprofit organizations for the delivery of public services through the nonprofit sector and any problems associated with those procedures. The study should also give consideration to the need for the creation of an independent commission to

facilitate communications between the public and nonprofit sectors.

Sec. 2. The Commission may report its findings and recommendations to the 1997 General Assembly.

Sec. 3. This resolution is effective upon ratification.

Explanation - House Joint Resolution

Legislative Proposal 3 is a House Joint Resolution that authorizes the Legislative Research Commission to study ways to facilitate greater cooperation between the public and nonprofit sectors and to foster the growth of the nonprofit sector. The House Select Committee on NonProfits, which studied the matter this year, found the issues involved in the matter to be so important as to merit additional study. Some of the issues left unresolved by the Committee include tax credits for the contribution of professional and technical services, an investigation of the red tape involved in the State contracting process, and the need for an independent commission to facilitate cooperation and communication between the public and nonprofit sectors. The Committee's work generated a lot of interest, both in-state and out-of-state. The Committee believes the work of this study would be enhanced if both houses participated in it. The Commission could report its findings and recommendations to the 1997 General Assembly.

APPENDIX A

AUTHORIZING LEGISLATION

GENERAL ASSEMBLY OF NORTH CAROLINA
1995 SESSION
RATIFIED BILL

CHAPTER 542
HOUSE BILL 898

AN ACT TO AUTHORIZE STUDIES BY THE LEGISLATIVE RESEARCH COMMISSION, TO CREATE AND CONTINUE VARIOUS COMMISSIONS, TO DIRECT STATE AGENCIES AND LEGISLATIVE OVERSIGHT COMMITTEES AND COMMISSIONS TO STUDY SPECIFIED ISSUES, TO MAKE VARIOUS STATUTORY CHANGES, AND TO MAKE TECHNICAL CORRECTIONS TO CHAPTER 507 OF THE 1995 SESSION LAWS.

The General Assembly of North Carolina enacts:

PART I.-----TITLE

Section 1. This act shall be known as "The Studies Act of 1995".

PART III.------SENATE AND HOUSE STUDIES

Sec. 3.1. The President Pro Tempore of the Senate may direct a Senate standing committee or select committee to study the following issues:

(a) Campaign reform (S.B. 982 - Plexico).

(b) Travel and Tourism Division of Department of Commerce merger with the Division of Parks and Recreation of the Department of Environment, Health, and Natural Resources (S.J.R. 1050 - Sherron).

Sec. 3.2. The Speaker of the House of Representatives may direct a House standing committee, permanent standing subcommittee, or select committee to study the following:

(a) Issues involved in tort reform which were introduced in the 1995 Regular Session of the General Assembly but not enacted (Daughtry).

(b) The facilitation of greater cooperation between the public and nonprofit sectors and the fostering of growth of the nonprofit sector, including, but not limited to, a review of government funding of nonprofits through State agencies, allowing local governments to take measures to encourage philanthropy within their communities and the feasibility of privatization of services and programs through nonprofit organizations (McMahan).

Sec. 3.3. A standing committee, permanent subcommittee, or select committee may report pursuant to this Part to the 1996 Regular Session of the 1995 General Assembly with any recommended legislation.

PART XXVI.-----EFFECTIVE DATE

Sec. 26.1. This act is effective upon ratification.

In the General Assembly read three times and ratified this the 29th day of July, 1995.

Dennis A. Wicker
President of the Senate

Harold J. Brubaker
Speaker of the House of Representatives

APPENDIX B

MEMBERSHIP AND STAFF OF THE HOUSE SELECT COMMITTEE ON NONPROFITS

HOUSE SELECT COMMITTEE ON NON-PROFITS
MEMBERSHIP
1996

Rep. W. Edwin McMahan
Chair
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Charlotte, NC 28211
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704 523-8661 (B)
704 525-2872 (Fax)

Rep. Walter W. Dickson
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704 864-1231 (R)

Rep. Joanne W. Bowie
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910 294-2587 (R)

Mr. Ed Ellis
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Mr. Henry Carter
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Rep. Leo Daughtry
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919 934-5013 (B)
919 934-9536 (Fax)

Mr. Paul Stam
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Apex, NC 27502
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919 387-1171 (Fax)

STAFF:

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Richard Bostic, Fiscal Research	(919) 733-4910
Martha Harris, Bill Drafting Division	(919) 733-6660
Sharon Cram, Committee Clerk	(919) 733-5191

APPENDIX C

SPEAKERS WHO ADDRESSED THE COMMITTEE

SPEAKERS WHO ADDRESSED THE COMMITTEE

JANUARY 18, 1996

Mr. Dan Gerlach, Fiscal Policy Analyst
N. C. Budget and Tax Center
How Will the Federal Budget Changes Affect Nonprofits

Ms. Jane Kendall, President
N. C. Center for Nonprofits
An Overview of the Nonprofit Sector in North Carolina

FEBRUARY 15, 1996

Mr. Charles Page, Vice President
United Way of Central Carolinas, Inc.
An Overview of Nonprofit Federations

Mr. Tom Lambeth, Executive Director
Z. Smith Reynolds Foundation, Inc.
North Carolina Foundations and Nonprofit Organizations

Mr. Jesse Norman, Internal Revenue Agent
Mr. Wally Reimold, Internal Revenue Agent
Internal Revenue Service
Requirements for Obtaining and Maintaining Federal Tax Exempt Status

MARCH 14, 1996

Mr. Richard Bostic, Committee Staff
Fiscal Research Division
What Incentives Make a Difference

The Honorable Ralph Campbell
State Auditor, State of North Carolina
Overview and Analysis of State Audit and Reporting Requirements

Mr. John Hood, President
John Locke Foundation
Charitable Contributions and the Tax Code

Ms. Jane Kendall, President
N. C. Center for Nonprofits
Recommendations for Increasing Charitable Giving
and Cutting Red Tape for Nonprofits

APPENDIX D

AN OVERVIEW OF THE NONPROFIT SECTOR IN NORTH CAROLINA

by

Jane Kendall
President, N.C. Center for Nonprofits

Attachment #1

An Overview of the Nonprofit Sector in North Carolina

Presented at the request of the N.C. House Select Committee on Nonprofits
January 18, 1996
by Jane C. Kendall, President, N.C. Center for Nonprofits

Thank you, Chairman McMahan, for inviting the N.C. Center for Nonprofits to brief this Select Committee about the nonprofit sector in North Carolina. I will say a word about the nonprofit organization I represent, give you an overview of the scope and structure of the nonprofit sector in North Carolina, tell you what nonprofits do in our state, summarize trends in the nonprofit sector, and finally describe the laws that govern nonprofits in North Carolina. Then I will be available for questions if you have time before your other speakers.

I. About the N.C. Center for Nonprofits

First, I'll say a quick word about the N.C. Center for Nonprofits. The Center was founded in 1990 by community leaders across the state to help nonprofit organizations of all types and sizes work *together* for a better North Carolina.

As a long-time nonprofit director myself, I had experienced the frustration of figuring out from scratch everything it took to lead and manage our organization -- issues such as legal compliance, accounting, strategic planning, fundraising, and building an effective board of directors. In 1990, a group of nonprofit leaders across the state came together because we realized we could all serve our communities and causes better if we pooled our resources and exchanged information about what works instead of each reinventing the wheel in isolation.

Over 18 months, 2,053 nonprofit board and staff members from all 100 counties across North Carolina participated in town meetings, interviews, and surveys. They told us about their biggest challenges in achieving their goals in the community. With this massive grassroots input and the help of 99 business and foundation leaders statewide, the Center began services in 1992 with a clear mandate.

We help nonprofits to: (1) lead and manage their organizations effectively, (2) cut costs, (3) exchange ideas and solutions, and (4) collaborate with each other and with business and government. The Center is an information center on effective practices, a statewide network for nonprofit board and staff members, and a voice for the state's charitable nonprofits.

Our services are open to all 501(c)(3) nonprofits in North Carolina. Already, 1,014 nonprofits in 90 counties have become Center members. Examples include the Red Cross in the Chairman's district in Charlotte, the Johnston County Education Foundation in Rep. Daughtry's home of Smithfield, the Shepherd's Center in Rep. Bowie's home county, YM/YWCAs from Asheville to the Triad and Triangle, and Cities/Communities in Schools which serves all of your home counties. Anyone can call our Board and Staff Helpline for help on effective nonprofit practices and legal compliance -- and more than 10,000 community leaders have already called in our first three years! The Center does not receive any government funds. We are funded by private dollars -- from nonprofits themselves and from foundations, corporations across the state, and individual donors.

II. Scope and Structure of the Nonprofit Sector

A. **A diverse, not monolithic sector.** Just as the business sector runs the gamut from small businesses like the corner grocery to international companies like IBM, the nonprofit sector is also very diverse. Nonprofits include tiny all-volunteer groups like a local PTA or Future Farmers of America chapter to large nonprofits like Duke University or Charlotte's Presbyterian Hospital. They work with issues from the arts to the environment, from education to health, from human services to economic development and literacy. The talents, skills, and perspectives of nonprofits are not monolithic, but as varied as those of the citizens and regions of North Carolina.

B. **Types and number of tax-exempt organizations.** The U.S. Internal Revenue Service has designated 21 different categories of tax-exempt organizations. Each category is named by the section of the Internal Revenue Code that relates to it. In your handouts, we have provided you with a list of the categories and the number of nonprofits in each one according the most recent figures available from the IRS.

North Carolina has a total of 25,064 organizations that fall into one of these 21 categories. Of these, 14,252 are 501(c)(3) nonprofits, which means their purpose is religious, educational, charitable, scientific, literary, or cultural. As you know, 501(c)(3) organizations can receive grants from private foundations, and your donations to them are deductible within certain limits. Groups of this type are often called "charitable" nonprofits.

The 501(c)(4) nonprofits include volunteer fire departments and homeowners associations. The typical 501(c)(6) is an association created to improve conditions for those in its line of business, such as the N.C. Retail Merchants Association or N.C. Citizens for Business and Industry. The 501(c)(8) nonprofits include groups like Rotary and Lions Clubs.

Most nonprofits are small, all-volunteer organizations. This may sound like a lot of nonprofit organizations until you think about all the 500 or so towns and 100 counties across North Carolina and all the types of community efforts undertaken through 501(c)(3) nonprofits. Most nonprofits are very small. For example, of the 14,000 nonprofits with 501(c)(3) status, more than nine out of 10 (86 percent) have total annual budgets under $100,000, and half have total budgets under $25,000. Their median annual expenses are just $37,431.

Of the 14,000 charitable nonprofits, more than 2,000 are local arts groups, and 1,000 are local PTAs. Grantmaking foundations like Bill Spencer's and Henry Carter's community foundations make up another 819 of them. Most of the private foundations are small and limited to giving in their own county – often to local colleges or the local United Way. More than 200 of the charitable nonprofits are local chapters of Future Farmers or Homemakers of America; almost 200 nonprofits are local chapters of the Daughters of the American Revolution or Sons or Daughters of the Confederacy. More than 100 are local arts councils like the Arts and Science Council in Chairman McMahan's district.

Other common nonprofits seen in many counties are Hospices (80), Little Leagues (30), and United Ways (74), and local chapters of Toastmasters clubs (100), the International Reading Association (50), and the Mental Health Association (28). Many are local rescue squads like the Elizabethtown Rescue Squad in Rep. Nye's district.

Many nonprofits are churches or church-related. Finally, all churches, synagogues, temples, and mosques in North Carolina are 501(c)(3) nonprofits, but they are not required to apply for official designation through the IRS or to file all the usual government reports and forms required for other nonprofits. About 500 of the 14,000 nonprofits are churches that did go through the full application process. In addition, many of the human service nonprofits are affiliated with a church or synagogue in North Carolina.

Summary on the number of nonprofits. While 25,000 nonprofit organizations may seem like a lot, only a little more than half of them are charitable nonprofits. Most of these are very small and local with a median annual budget of about $37,000. Only about 2,000 have total annual budgets of $100,000 or more.

C. **How does an organization become tax-exempt?** It's really the federal government that determines whether an organization is a tax-exempt nonprofit. To become tax-exempt under the federal Internal Revenue Code, an organization must first incorporate in North Carolina as a nonprofit corporation. This includes establishing a board of directors, filing articles of incorporation and bylaws with the N.C. Secretary of State, and receiving state recognition as a nonprofit corporation. Then the group completes a long, multi-part application to the U.S. Internal Revenue Service. After submitting the form to apply for 501(c)(3) status, the IRS usually sends back an additional list of detailed questions to ensure that the organization is organized for broad societal benefit rather than private gain. The process can take from three months to three years.

III. The Roles of Nonprofits: What Do North Carolinians Look to Nonprofits to Do?

Nonprofit organizations are part of the basic fabric of our communities. Together, they represent an increasingly important sector of our state. They function on a not-for-profit basis, they are entrusted with public purposes, and they are barred by law from private gain. They form the heart of most of our communities, and government and business both have a fundamental stake in preserving and strengthening them.

I wish you could see and hear what I see nonprofits do every day for this state. They accomplish so much with so little money and so much commitment and resourcefulness. Let me try to draw you a picture of some of the types of things our citizens look to them to do across North Carolina.

A. First, nonprofits provide opportunities for religious worship and spiritual growth. As I mentioned before, all churches, synagogues, and mosques are all 501(c)(3) nonprofits.

B. The second role of nonprofits is to deliver services needed in the community – at food banks, soup kitchens, homeless shelters, arts programs, Red Cross chapters, river clean-up projects, and YMCAs and YWCAs. Nonprofits offer an intimate knowledge of their communities and a cadre of committed board members and other local volunteers. Examples of nonprofits delivering needed services are the Metrolina Food Bank in Chairman McMahan's and Rep. Dickson's district, the Benson Children's Home in Rep. Daughtry's district, the Edenton-Chowan Food Pantry run by Jane Williams in Rep. Culpepper's district, Step-Up Ministry and Goodwill Industries in Skip Stam's home county, and Crisis Control Ministry in Henry Carter's county.

C. The third role for which North Carolinians look to nonprofits is to provide avenues for citizens to get involved as volunteers. How many of you have done volunteer work in the past month? One of the great things about America is that 48 percent of American adults volunteer an average of 4.2 hours a week. That's $182 billion worth of work given free through nonprofit organizations. A statewide Carolina Poll found in 1995 that 53 percent of North Carolinians volunteer -- more than half of our entire adult population! *And* they look to nonprofits to provide these volunteer opportunities so they can make a difference in their communities and feel connected to their neighbors. Nonprofit leaders like Molly Keeney of the Volunteer Center of Greensboro in Rep. Bowie's district and Mary Hall of the Dare Voluntary Action Center in Rep. Culpepper's district match up thousands of citizens with nonprofits who need good volunteers.

D. The fourth thing nonprofits do in North Carolina is to serve as a testing ground for solutions to problems. One of nonprofits' strengths is that they provide ways for groups of citizens to come together voluntarily to solve problems in their community. They act as incubators to experiment with different solutions to complex local and statewide issues. This diversity of approaches is an important aspect of the entrepreneurial nature of the nonprofit sector as a private marketplace of ideas serving the public interest. The Center for Community Self-Help, for example, has figured out how to leverage public and private dollars to provide almost 1,700 loans to low-income individuals for home mortgages and small businesses and to nonprofits -- loans that private banks thought were too high a risk.

E. Fifth, nonprofits are often a source of ideas that help develop public policy options for government to consider -- options that government itself does not have the time or research capacity to develop. For example, the N.C. Victims Assistance Network did some of the research that helped the General Assembly consider and pass the Victims' Bill of Rights last year.

F. Sixth, nonprofits provide a voice for underrepresented citizens, such as children, crime victims, or people with severe disabilities whose needs would otherwise go unheard in the halls of government. For example, it was a nonprofit, the N.C. Low Income Housing Coalition, that brought to the attention of the legislative leadership the value of the Housing Trust Fund and the fact that it had been left out of the budget this year. I believe the Speaker has indicated this was an oversight that could be remedied in the short session in May.

G. The seventh role of nonprofits is to educate the public on issues facing our society. Nonprofits are often the primary source for educating citizens about issues from immunization to child abuse to literacy to recycling. For example, Prevent Child Abuse North Carolina here in Mr. Stam's home of Wake County conducts a major annual campaign to help people learn more about this important issue.

H. Lastly, nonprofits have a key role in providing structures for citizen participation in a free society. Nonprofits provide the organizations through which citizens exercise their freedom of religion, association, assembly, and speech. In these fundamental ways, nonprofits help form the cornerstone of a free society and of our democracy. For example, citizens volunteering through the Episcopal Housing Ministry have been gathering to talk with city officials about ways to increase affordable housing in Greensboro in Rep. Bowie's home county.

Like government agencies, nonprofits are tax-exempt because they fulfill a public purpose and provide public goods. They are created for societal benefit. But like business, nonprofits are private organizations and they share the business sector's flexibility and ability to adapt to changing conditions more quickly than government can. Nonprofits thus serve as our state's *private* entrepreneurs in the *public* interest.

IV. Trends in the Nonprofit Sector: Increasing Expectations, Decreasing Resources

Now I want to turn to three key trends affecting the nonprofit sector that are relevant to the Committee's work.

TREND #1: Volunteer pools are shrinking. With more and more parents now working, people have less time to volunteer. And, as corporations downsize, many are not able to be as generous in encouraging their employees to volunteer. As a result, nonprofits that depend on large numbers of volunteers -- such as homeless shelters, soup kitchens, Boy Scouts and Girl Scouts, and the Salvation Army -- are experiencing some major challenges. As demands for nonprofit services rise, this shrinking pool of volunteers will become a bigger problem.

TREND #2: Government cuts will impact nonprofits negatively from three directions. Since Dan Gerlach will speak to you later about the effects of federal budget cuts on North Carolina, I will just summarize the three main ways federal budget cuts may affect the state's nonprofits.

First, demand for nonprofits' services will continue to rise. Demand is up and expected to increase even faster if government-funded programs for human services, housing, and others are cut or eliminated. For example, the Crisis Assistance Ministry in Chairman McMahan's, Bill Spencer's, and Ed Ellis' city of Charlotte has already seen a 20 percent increase in requests for emergency help in December 1995 compared to December 1994.

Second, cuts in public programs currently delivered by nonprofits will have a major impact. Nonprofits that currently serve as the vehicle for delivering government-funded programs will likely experience direct cuts in their budgets. If the 1996 Congressional budget resolution approved on June 29 were enacted, for example, federal support for nonprofits would be 26 percent below current levels by the federal Fiscal Year 2002. Nonprofits would lose a cumulative total of $263.3 billion in direct federal revenues between 1996 and 2002.

Third, private charitable dollars will be stretched even thinner. Nonprofits will see increased competition for private charitable dollars which are already stretched very thin. This competition will come from nonprofits seeking private donations to continue services dropped by government, those seeking donations to create or expand programs in response to rising demand for their services, and from government itself asking foundations and corporations for private charitable dollars. As a trustee of a private foundation in Greensboro, I see more and more government agencies coming to private foundations for funds for public programs.

TREND 3: Private giving will be unable to make up the difference when government funds are cut. To offset these direct losses to nonprofits because of federal cuts, private charitable giving would have to increase at a rate far above its historical rate of increase. Alan Abramson of a think tank called The Aspen Institute estimates that to offset the direct revenue losses, private giving would have to increase by 28 percent in 1997 and by 105 percent by 2002. This would be more than 16 times the current annual rate of increase in private giving, which averages about 3 percent per year. Four out of five North Carolina households already give to nonprofits.

You may think private foundations are a likely source of new nonprofit funding, but this is a very limited pool, too. Only about 7 percent of private charitable dollars come from foundations. The total given by all 819 North Carolina foundations is about $220 million annually. Of this, some goes out of state. Even more is restricted to specific institutions or purposes. Many foundations are small and give only in their town or county and for limited purposes. Even the largest foundation, The Duke Endowment, gives its $48 million only to four private universities (one of which is in South Carolina) and to particular hospitals and children's homes in North and South Carolina as specified in the will that created the Endowment. Similarly, the Kate B. Reynolds Health Care Trust is restricted to the "poor and needy" only in Forsyth County and to health projects serving low-income residents. And, the William R. Kenan Jr. Charitable Trust goes to pre-selected nonprofits in pre-selected fields, many of which are out-of-state.

So there's less discretionary money in foundations than most people think. Foundation grantmaking is limited to the earnings on their investments from their endowments, so they can't just decide to increase their giving (as much as they'd like to).

And, don't think corporations can fill in the gap. Corporations contribute only 4-5 percent of all private charitable dollars. North Carolina has wonderful, community-spirited foundations and corporations, but they couldn't make up the difference in expected government cuts even if they wanted to.

In short, private giving in North Carolina is strong, but it will not be able to pick up the gaps created by reduced government without the introduction of new and serious incentives -- which is one thing this Committee might consider doing.

V. Laws that Govern Nonprofit Corporations

Please see the handouts I provided for examples and details about some of the laws that govern private, nonprofit corporations in North Carolina. The N.C. Center for Nonprofits has been a partner with state government in educating nonprofits about the laws with which they must comply. Last year, for example, we hosted two seminars for almost 400 nonprofits on "Keeping in Compliance" with the N.C. Department of Revenue. Officials from the IRS and various state departments that regulate nonprofits described the laws and regulations that nonprofits must follow.

The N.C. Nonprofit Corporation Act spells out the laws nonprofits must follow related to their incorporation, bylaws, boards of directors, members, records, liability, and fees. This law was revised in 1993 to make it consistent with the Business Corporation Act.

After nonprofits are incorporated and have their bylaws in order, they apply to the IRS for federal tax exemption. Then they have to show each year that they are receiving broad public support and that their activities still fit their charitable purpose. The long, multi-part form submitted to the IRS each year is open to public inspection. The Internal Revenue Code includes reams of regulations on everything a nonprofit must do. The rules vary for each of the 21 categories of nonprofits. New regulations are added each year, so just keeping up with them requires the help of a skilled tax attorney.

If a nonprofit needs to raise money, it has to apply each year -- using a very long form -- for a Charitable Solicitation License and pay a fee to the N.C. Department of Human Resources.

A nonprofit with employees has to report to a total of at least four departments of the federal government and eight departments of state government. See the handout for a list.

If a nonprofit receives any state funds, it is accountable for every penny to the Department of the State Auditor and to the agency that supplies their grant or contract. If a nonprofit receives more than $25,000 in state funds, it must also have a special -- and very expensive -- audit done in addition to its regular independent audit by a CPA. This is something else you might want to take a look at.

VI. In Conclusion

Thank you for inviting the Center to provide an overview for you today. I've given you a snapshot of the scope and structure of the state's nonprofit sector, the variety of roles nonprofits play across the state, the rising expectations on nonprofits and the lack of new resources to respond, and the state and federal laws that govern nonprofit corporations.

We welcome the opportunity to work with the House Select Committee in finding ways to help you fulfill your mandate to "facilitate greater cooperation between the public and nonprofit sectors and [foster] growth of the nonprofit sector" (HB 898, Part III). For example, you may want to try to create incentives for increasing charitable giving.

We at the N.C. Center for Nonprofits would like to survey other states and bring specific recommendations to you in March in two areas: (1) potential tax incentives to increase charitable giving; and (2) specific legal changes that would enable nonprofits to serve the people of North Carolina better. We'd also like to explore some of the barriers in partnerships between the government and nonprofit sectors to see if we can suggest any legislative actions that could be productive.

I hope this provides a helpful foundation for your work together. I'd be glad to respond to questions if there's time, Mr. Chairman. I must tell you, though, that today is my 45th birthday, so I don't want you to ask me any hard ones. Thank you for inviting me here today.

The Roles of the Nonprofit Sector:

What Do North Carolinians Look to Nonprofits to Do?

1. Provide opportunities for religious worship and spiritual growth
2. Deliver services needed in the community
3. Provide avenues for citizens to get involved as volunteers
4. Serve as a testing ground for solutions to community problems
5. Develop public policy options for government to consider
6. Provide a voice for underrepresented citizens
7. Educate the public on issues facing our society
8. Provide structures for citizen participation in a free society

CATEGORIES OF SPECIAL NONPROFIT TAX EXEMPT ORGANIZATIONS

Section of the U.S. Internal Revenue Code:	Description:	Number of Entities in North Carolina:
501(c)(1)	Corporations originated under Act of Congress, including Federal Credit Unions. These are considered instrumentalities of the United States.	0
501(c)(2)	Title-holding corporation for a tax-exempt organization.	40
501(c)(3)	Religious, educational, charitable, scientific, and literary organizations, and those testing for public safety, fostering certain national or international sports competitions, or working to prevent cruelty to children or animals. Includes private foundations. (Part of the independent sector universe.)	14252
501(c)(4)	Civic leagues, social welfare organizations, local associations of employees. These are organizations promoting community welfare, charitable, educational, or recreational activities. (Part of the independent sector universe.)	3430
501(c)(5)	Labor, agricultural, horticultural organizations. These are educational or instructive groups whose purposes include improving conditions of work, products, and efficiency.	919
501(c)(6)	Business leagues, chambers of commerce, real estate boards, etc., formed to improve conditions in one or more lines of business.	1674
501(c)(7)	Social and recreational clubs which provide pleasure, recreation, and social activities.	1356
501(c)(8)	Fraternal beneficiary societies and associations, with lodges providing for payment of life, sickness, accident, or other benefits to members.	1806
501(c)(9)	Voluntary employees' beneficiary associations (including federal employees' voluntary beneficiary associations formerly covered by section 501(c)(10), providing payment of life, sickness, accident, or other benefits to members.	261
501(c)(10)	Domestic fraternal societies and associations - lodges devoting their net earnings to charitable, fraternal, and other specified purposes. No life, sickness, or accident benefits to members.	225
501(c)(11)	Teachers' retirement fund associations.	
501(c)(12)	Benevolent life insurance associations, mutual ditch or irrigation companies, mutual or cooperative telephone companies, etc. These are groups with activities similar to those implied by the descriptions of class of organization beneficial to members.	85
501(c)(13)	Cemetery companies, providing burial and incidental activities for members.	129
501(c)(14)	State-chartered credit unions, mutual reserve funds, offering loans to members. (Exemption for building and loan associations and cooperative banks repealed by Revenue Act of 1951, affecting all years thereafter.)	143
501(c)(15)	Mutual insurance companies or associations, providing insurance to members substantially at cost (limited to organizations with gross income of $150,000 or less).	187
501(c)(16)	Cooperative organizations to finance crop operations, in conjunction with activities of marketing or purchasing associations.	
501(c)(17)	Supplemental unemployment benefit trusts, providing payments of supplemental unemployment compensation benefits.	3
501(c)(18)	Employee-funded pension trusts, providing benefits under a pension plan funded by employees, created before June 25, 1959.	
501(c)(19)	Post or organization of war veterans.	554
501(c)(20)	Trusts for prepaid group legal services, as part of a qualified group legal service plan or plans. Applicable to taxable years beginning after December 31, 1977.	
501(c)(21)	Black lung trusts, satisfying claims for compensation under Black Lung Acts.	

Source: IRS Exempt Organizations Business Master File, 9/22/95

Selected Laws that Govern N.C. Nonprofits

Prepared by the N.C. Center for Nonprofits, January 18, 1996

Federal laws:

Law	Accountable to:	Actions and reports required of nonprofits:
Internal Revenue Code	U.S. Internal Revenue Service	Submit application to become a tax-exempt organization. For charitable nonprofits, this means completing and filing the long Form 1023, responding to the IRS investigation, and paying a fee. If initial exemption is granted, the nonprofit must prove after five years that it has attained a defined level of general public support in order to be granted exemption past this five-year "advanced ruling period". File Form 990 (or 990PF for private foundations) each year with extensive reporting of all revenue sources and amounts, expenditures, and activities. Obtain Federal Employer ID number. File regular Federal Tax Deposits (required reporting schedule varies by size of payroll). Must also file the Employer's Quarterly Federal Tax Return and collect a W-4 Form for each employee. Provide receipts, notices of items of value given to donors, and other required communications to donors.
Social security	U.S. Social Security Administration	W-2 and W-3 Forms for Social Security's annual reconciliation.
Immigration Reform and Control Act	U.S. Immigration and Naturalization Service	Complete and maintain a I-9 Form for each employee.
Other employment-related laws/acts: Age Discrimination Act, Americans with Disabilities Act, Fair Labor Standards Act, Family and Medical Leave Act, Pregnancy Discrimination Act, Title VII of Civil Rights Act of 1964	U.S. Department of Labor; Equal Employment Opportunity Commission	Comply with these and other employment-related laws.

State Laws:

Law	Accountable to:	Actions and reports required of nonprofits:
N.C. Nonprofit Corporation Act (N.C. General Statutes, Chapter 55A)	N.C. Secretary of State	File articles of incorporation, bylaws, application to be a nonprofit corporation; pay fee; establish registered agent. Comply with laws on articles, bylaws, boards, members, records, directors and officers liability.
N.C. Charitable Solicitations Act (NCGS Chapter 131F)	N.C. Department of Human Resources, Solicitation Licensing Branch	File the initial and annual Application for License for Charitable Solicitation including multiple sections and attachments, and pay an annual fee. This is required for any nonprofit raising $25,000 or more, or using the services of a professional solicitor.

CONTINUED

State Laws (cont.):

	Accountable to:	Actions and reports required of nonprofits:
N.C. Occupational Safety and Health Act (NCGS 95-126,-160)	N.C. Department of Labor	Post information in the workplace. Comply with all provisions of the law.
Unemployment Compensation (NCGS Chapter 96)	N.C. Employment Security Commission	Post information in the workplace. A 501(c)(3) nonprofit owes this tax when it has at least 4 full- or part-time employees during 20 weeks in one calendar year. Must apply for Unemployment Tax Number and then file Employer's Quarterly Tax and Wage Report.
Wage Protection Act (NCGS 95-25.13,-25.7,-25.10,-28.8)	N.C. Department of Labor, Wage and Hour Division	Compliance with state laws governing paydays, sick and annual leave, and deductions from wages.
Income taxes withheld	N.C. Department of Revenue	Obtain State Withholding Identification number. File monthly State Withholding Report and the Employer's Annual Reconciliation Report.
Sales and use tax	N.C. Department of Revenue, Sales and Use Tax Unit	Quarterly report of sales taxes collected with payment enclosed. File semi-annual report of all eligible taxes paid, with refund request.
State franchise and income tax (NCGS 105-125,-130.11[3])	N.C. Department of Revenue	Apply for exemption from state income and franchise taxes.
Raffles (NCGS 14-309.15)	N.C. Attorney General's Office	Comply with all provisions of the raffle-related laws for nonprofits.
Worker's compensation (NCGS Chapter 97)	N.C. Industrial Commission	Provide worker's compensation coverage if have three or more employees.
Accountability for expenditure of state funds	N.C. Department of the State Auditor; state agency issuing the grant or contract	Have annual external audit done; provide full accounting to relevant state agency; arrange for and pay for special additional audit requirements for nonprofits receiving $25,000 or more in state funds.
Other laws with which nonprofit employers must comply: Blacklisting (NCGS 14-355), Communicable Disease Law (130A-143, 148), Drug Testing (95-230 to 232), Handicapped Protection (168A-1 to 12), Medical Examinations (14-357.1), Retaliatory Employment Discrimination (95-240 to 244), Separate Facilities (95-48 to 53), Sickle Cell Trait (95-28.1), Use of Lawful Products (95-28.2)		

County and municipal government:

Local ordinances	County, City, or Town	Comply with them.
Property taxes	County Tax Assessor	File annual business property statement. Can apply for local property tax exemption.

APPENDIX E

HOW WILL THE FEDERAL BUDGET CHANGES AFFECT NONPROFITS?

by

Dan Gerlach
Fiscal Policy Analyst, North Carolina Budget and Tax Center

Attachment # 3

HOW WILL THE FEDERAL BUDGET CHANGES AFFECT NONPROFITS?

Presentation to the House Select Committee on Nonprofits

January 18, 1996

Dan Gerlach
Fiscal Policy Analyst
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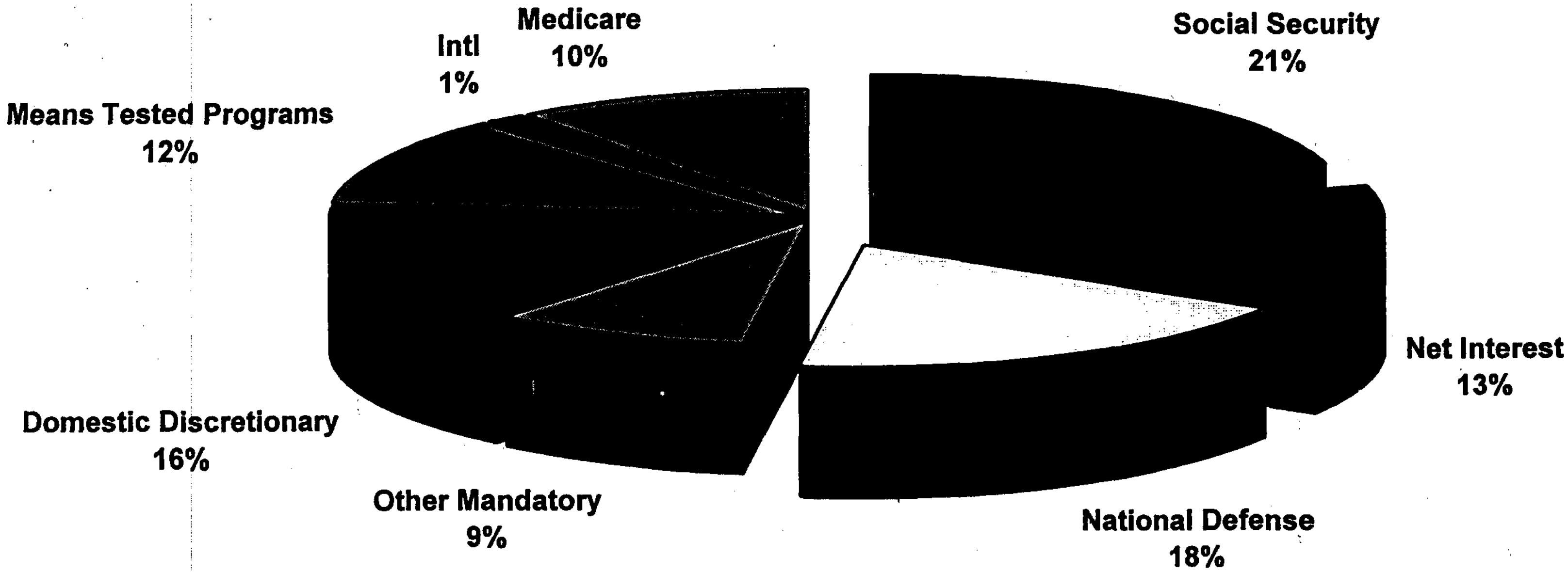
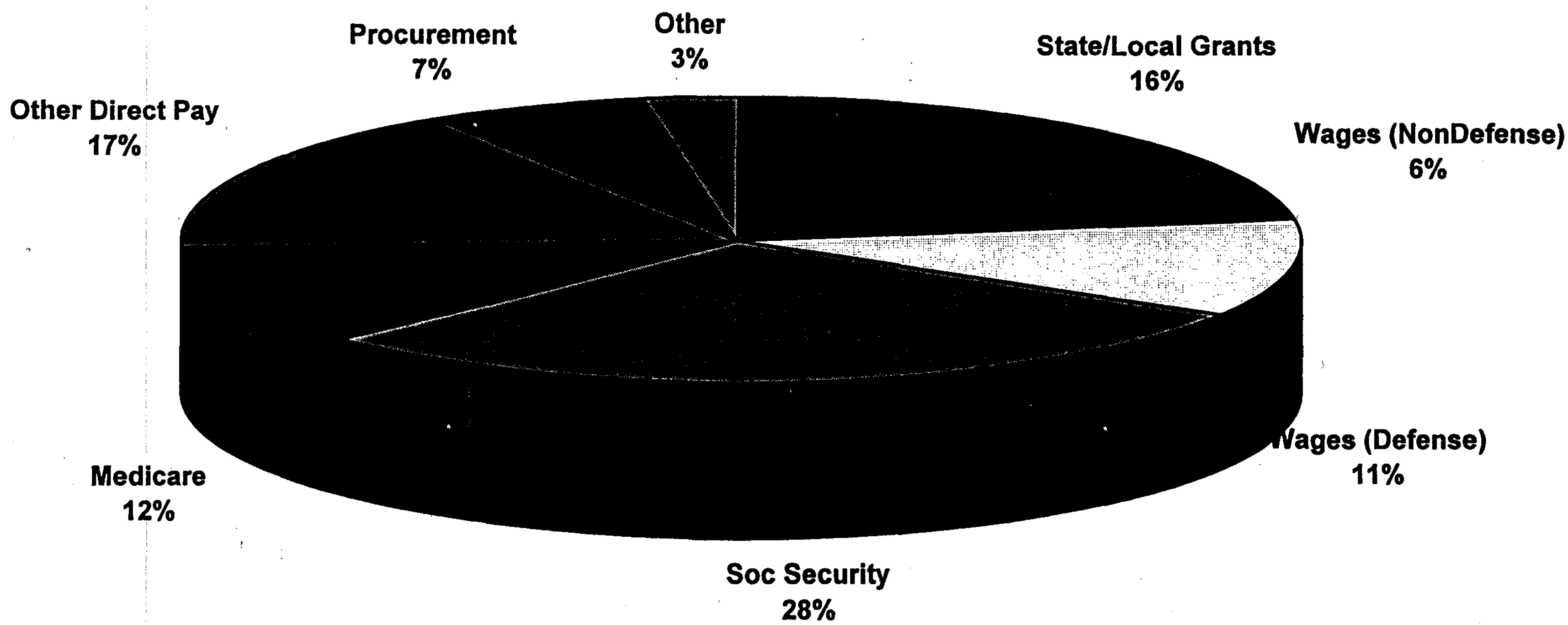
Federal Government Spending, FY 1994



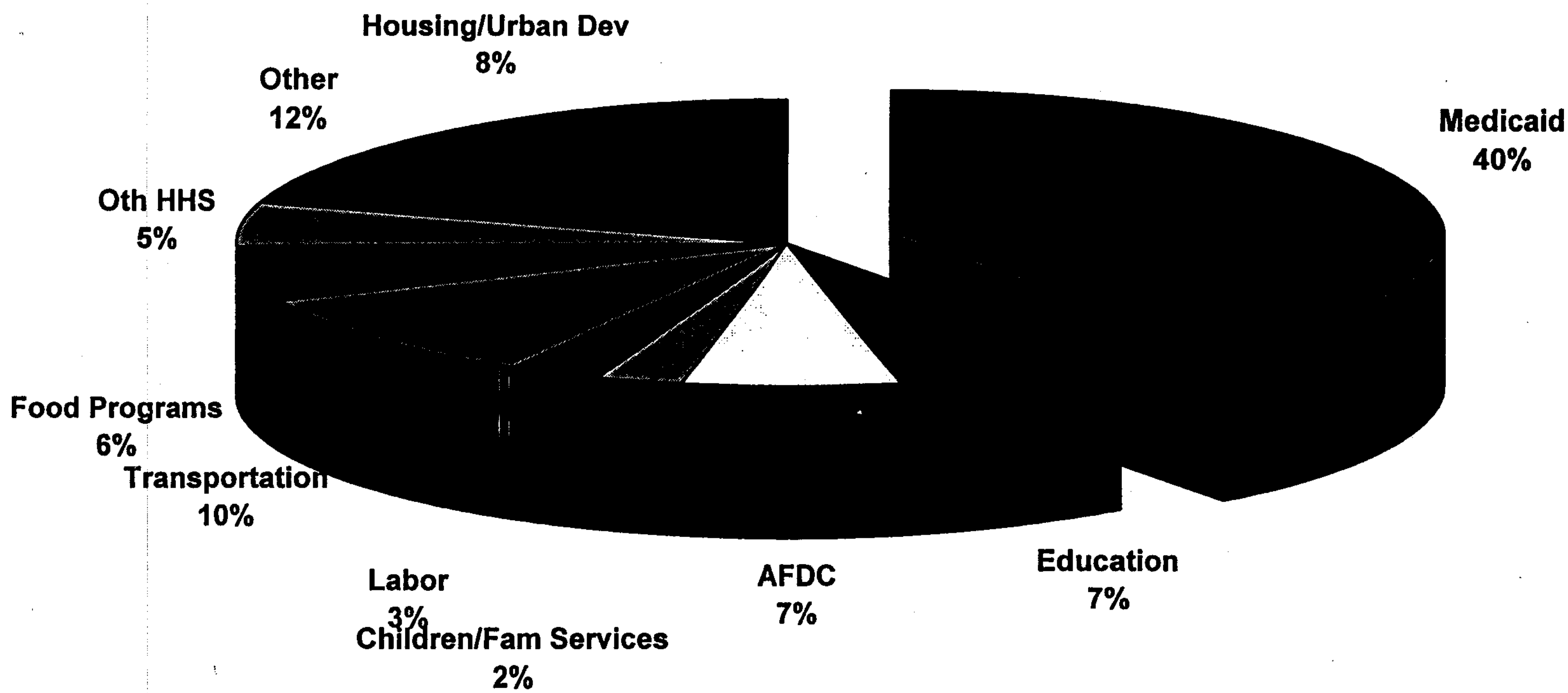
NC Budget and Tax Center

Federal Spending in North Carolina, FY 1994 (Total of $28.9 Billion)



NC Budget and Tax Center

Federal Grants to North Carolina State and Local Governments, FY 1994 Total of $4.86 Billion



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HOW IS OUR POPULATION CHANGING?

The poor, the elderly and children traditionally require more governmental services than the population as a whole.

- **the poverty rate increased from 12.2 percent in 1989 to 15.7 percent in 1992 and stood at 14.2 percent in 1994**

- **the number of school-aged children is growing twice as fast as the population as a whole;**

- **the number of the very elderly will increase by 60 percent between 1990 and 2000;**

HOW WILL THE BUDGET BE BALANCED IN THE YEAR 2002?

Total Deficit	$349 billion
- Medicare	$71 billion
- Medicaid	$50 billion
- Freeze Discretionary Pgms	$96 billion
- Cuts in Discretionary Pgms	$34 billion
- Cuts in Mandated Pgms	$25 billion
- Cuts in Interest Payments	$58 billion
- "Fiscal Dividend"	$50 billion
Equals a surplus of	$34 billion
But tax cuts equal	$30 billion

So the net surplus in 2002 is estimated at $4 billion

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WHAT DOES BALANCING THE FEDERAL BUDGET MEAN FOR THE ECONOMY?

- **Most economists believe interest rates will fall as the Federal government borrows less - therefore it may become cheaper to buy a home or get loans for businesses;**

- **Reductions in taxes on capital gains and other business taxes may lead to an increase in savings and investment, so more capital may be made available to small businesses;**

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WHAT IS A BUDGET CUT?

To provide the same level of services, governments have to spend more in the future than they did in the past, because:

- **the cost of salaries, equipment and supplies increases; and**

- **the number of people needing services increases.**

So, when we talk about cuts, we mean cuts in <u>services</u> from last year's level, not just cuts in dollar amounts from last year's level.

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WHERE WILL THE MONEY COME FROM IN THE BUDGET RECONCILIATION BILL?

- **Medicare - $270 billion**
- **Medicaid - $132 billion**
- **Food Stamps/Other Commodities - $28.3 billion**
- **Earned Income Credit - $32.3 billion**
- **Restrictions on Benefits for Legal Aliens - $20.9 billion;**
- **Supplemental Security Income - $14.5 billion;**
- **Public Assistance Block Grants - $10.9 billion;**
- **Child Nutrition - $5.3 billion;**

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WHO ELSE WILL FEEL THE REDUCTIONS?

- Housing Programs were reduced by an average of 21 percent from 1995 levels - HUD Appropriations were reduced by $6.1 billion in one year alone. These reductions include:

- 44 percent reduction in severely distressed public housing;
- 25 percent reduction in assisted housing;
- 27 percent reduction in funding for homeless programs;

- Housing and the Low-Income Home Energy Assistance Program had experienced midyear reductions in 1995 under the recissions bill adopted by Congress and signed by the President.

- Funding for arts and humanities programs are also under review for reductions.

- Funding for the Legal Services Corporation has been reduced by 30 percent under the Congressional budget.

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WHAT'S IN THE CURRENT WELFARE REFORM BILL?

1. Entitlements to AFDC, JOBS and Emergency Assistance are ended and replaced with block grants;

2. Block grants for North Carolina would be fixed at 1995 levels and would grow by 2.5 percent each year;

3. Certain populations could not receive AFDC, unless state passes a law expressly to allow them to receive assistance (such as the family cap);

4. There is a five-year lifetime limit on cash assistance grants;

5. States (and localities) would have to spend at least 75 percent of their 1994 appropriations to serve this population. This would have to continue each year through 2002.

6. Toughened work requirements for both cash assistance and food stamp recipients;

7. Toughened eligibility criteria for SSI;

8. Separate funding stream for child care block grant;

9. Optional Food Stamp Block Grant for some states.

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MEDICAID IN NORTH CAROLINA

- **Between 1988 and 1993, Medicaid expenditures increased by an average of 23 percent each year in North Carolina, ranking 10th in the nation;**

- **Growth was due to enrollment increases, as our growth in spending per patient was one of the ten lowest in the nation;**

- **Almost half of our Medicaid beneficiaries in 1993 were children, one-quarter were nonelderly adults, 15 percent were elderly and the remainder were disabled or blind;**

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EARNED INCOME TAX CREDIT (EITC)

- Program started in 1975 to encourage work and to offset payroll taxes for low-income people;

- Historically has enjoyed bipartisan support, with expansions of the program under Presidents Reagan, Bush and Clinton;

- In 1995, over 650,000 North Carolinians earning under $30,000 each year received $545 million in benefits from this credit;

- The House Ways & Means Committee has acted to reduce the credit for families earning between $11,000 and $27,000 each year, for families receiving child support or Social Security and to eliminate the credit for childless low-income individuals;

- Proposals are pending in the Senate to enact the provisions of the House bill and to stop the adjustment for inflation;

- Would result in tax increases for the working poor (about 200,000 North Carolina families)

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HOUSING POLICY

- In 1993, the South had approximately 4 million low-income renters, but only 2.2 affordable rental units (units where the renter paid 30 percent or less of her income in rent). Nationally, the number of unsubsidized affordable rental units has fallen from 5.1 million in 1973 to 2.9 million in 1993 ;

- Nearly half of all homeowners spent more than 50 percent of their income in housing in 1993;

- Subsidized housing has increased from 20 percent to almost 50 percent of the total affordable housing market over the last twenty years;

SO WHO WOULD BE MOST AFFECTED BY THE CHANGES?

- **Nonprofits which receive federal money directly for:**

- **health care (both physical and mental);**
- **housing assistance;**
- **nutrition programs;**
- **homeless assistance;**
- **programs serving teenage mothers or to reduce teenage pregnancy;**
- **programs focusing on assistance for legal immigrants;**

Nonprofits which do not receive federal money directly, but who would experience increase in demands for services:

- **programs listed above;**
- **substance abuse programs;**
- **crisis assistance - cutbacks in several other areas could affect demand for temporary help;**
- **domestic violence/child abuse & neglect programs;**
- **foundations experiencing increases in funding requests from other nonprofits;**
- **child care agencies;**

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WHAT CAN BE DONE?

- *Save for a Rainy Day* - **General Assembly did not spend $193 million in 1995. This money could help with a transition period for many services;**

- *Don't Panic - Plan Ahead* - **North Carolina is still economically healthy and many of the Congressional proposals are not finalized. Use this time to get public input from local clients and providers.**

- *Solutions will be Complex* - **Federal reductions will require the State, local governments, private and nonprofit sector organizations to engage in partnerships. No sector can handle the changes in responsibilities alone.**

- *Maximize services.* **Funding should be used for programs whenever possible - not administration.**

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1/18/96

APPENDIX F

RECOMMENDATIONS FOR INCREASING CHARITABLE GIVING AND CUTTING RED TAPE FOR NONPROFITS

by

Jane Kendall
President, N.C. Center for Nonprofits

Recommendations for Increasing Charitable Giving and Cutting Red Tape for Nonprofits

Presented March 14, 1996 at the request of the N.C. House Select Committee on Nonprofits
by Jane C. Kendall, President
N.C. Center for Nonprofits, (919) 571-0811, fax (919) 571-8693

Thank you, Chairman McMahan, for inviting the N.C. Center for Nonprofits before this Select Committee a second time – this time to make recommendations to the Committee on ways to increase charitable giving and to cut red tape for the nonprofits that serve North Carolina. For the members who were not able to attend that meeting, the Center is a private, nonprofit organization created in 1990 by more than 2,000 community leaders from all 100 counties across North Carolina. We help charitable nonprofits to: (1) lead and manage their organizations effectively, (2) cut costs, (3) exchange ideas and solutions, and (4) collaborate with each other and with business and government.

The N.C. Center for Nonprofits is an information center on effective nonprofit practices and on emerging issues in the nonprofit sector. It is also the statewide network and advocate for board and staff members in nonprofit organizations in all fields – from the United Way to Wake Forest University, from the Arts Council to the Red Cross, from Habitat for Humanity to Communities in Schools.

With 1,027 member nonprofits in 90 counties, we offer technical assistance and other services to board and staff members and volunteers in all 501(c)(3) charitable nonprofits in the state.

In consultation with Chairman McMahan and members of the Committee, I will present five recommendations today that are feasible for passage in the short session of the General Assembly this year. We have spent a great deal of time working with your staff to research options for meeting two goals: to increase charitable giving and to cut red tape for the nonprofits that serve the people of North Carolina.

Sometimes these tax-related ideas get a bit technical and may not be too exciting, but my personal goal for today is for this testimony to be at least as entertaining as the tag team presentation by the two very knowledgeable IRS representatives at your last meeting.

After the Committee's first two meetings, we counted 17 ideas from members of this Committee or from nonprofits across the state. After researching these, we sent nine potential recommendations to 2,500 nonprofit leaders in communities across the state. Since then, we have received responses and input from nonprofits in your districts across North Carolina from Edenton to Smithfield and from Greensboro and Winston-Salem to Charlotte and Gastonia. In early March, our statewide Board of Directors volunteered an entire weekend to review all this input and narrow our recommendations down to five.

We tapped the extensive research by the National Center for Charitable Statistics and Independent Sector, a national organization that supports giving and volunteering through the nonprofit – or "independent" – sector. We also talked with Dr. Charles Clotfelter, a national expert in charitable contributions and the director of the Center for the Study of Philanthropy and Voluntarism at Duke University.

At the state level, research by fiscal analyst Dan Gerlach of the N.C. Budget and Tax Center has been very helpful. I also want to praise particularly the fine work of your staff Martha Harris, Cindy Avrette, and Richard Bostic. I would also like to recognize Kate McGuire of the N.C. Center for Nonprofits who is here today as a resource to the Committee.

The following five recommendations may not be the only ones that would be good for this Committee to make. We tried to focus on those that: (1) can benefit the most North Carolinians, (2) can help all charitable 501(c)(3) nonprofits, (3) have the best possible chance of passing in the short session, and (4) will not cost the state a lot of money.

The legislative staff will provide details on several of these proposals later today, so I will just give you the essence now and tell you why each one is important. Extra copies of our handout are on the table for anyone in the room who would like one.

FIRST GOAL: Increase charitable giving in North Carolina

Recommendation 1 for increasing charitable giving:

Create a 7% tax credit for charitable contributions given by North Carolinians who do not itemize on their federal tax returns (and who thus are not currently allowed to deduct their charitable contributions on their federal *or* state returns). We recommend using a floor of 2% of taxable income because 2% is the average percentage of their income that North Carolinians contribute to nonprofits. A 2% floor would thus acknowledge and encourage giving that is *above* the average. So non-itemizers would get a 7% tax credit on their total donations that *exceed* 2% of their income.

Why?

- Reason 1: This will encourage people to give more. The 71% of North Carolina taxpayers who do not itemize their deductions currently have no tax incentive to increase their charitable giving because they cannot claim deductions for their donations. This proposed change can make a difference, however, because non-itemizers pay attention to tax incentives for charitable contributions. From 1981 to 1985, for example, federal law allowed non-itemizers to deduct 50% of their charitable contributions on their federal returns, so in 1985, they gave a total of $9.5 billion across the country, according to the Internal Revenue Service. In 1986, however, they were able to deduct a full 100%, and they increased their giving to $13.4 billion – an increase of 40%. The message from that experience is clear: Charitable tax incentives *can* stimulate substantially increased giving from middle-income citizens.

- Reason 2: This will affect most taxpayers (and voters) because 71% are non-itemizers. People who *itemize* on their federal tax returns *are allowed* to deduct their charitable contributions on both their federal and state returns. Those who do *not itemize,* however, are *not allowed* to deduct their contributions on their federal *or* state returns.

  For example, the chart on the next page shows the number of households in selected counties that would benefit from a tax credit for non-itemizers.

Recommendation 1 for increasing charitable giving (continued)

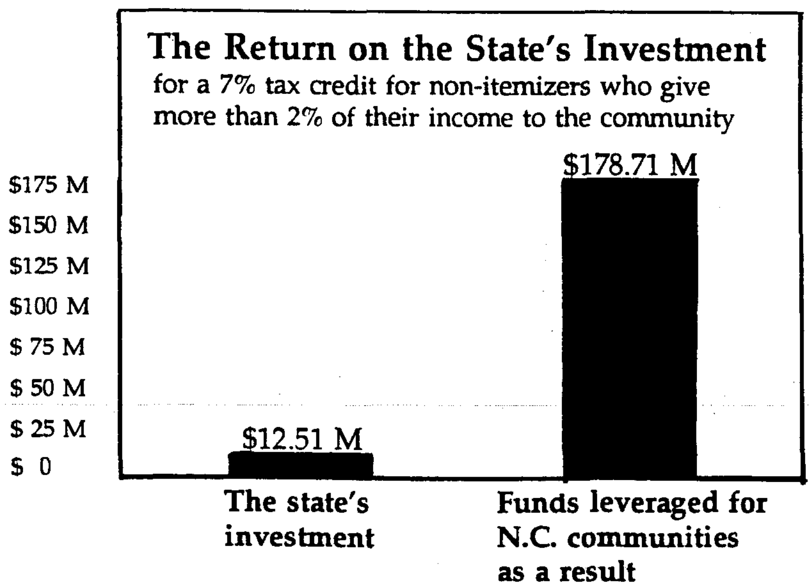
County:	Number of households benefitting from tax credit for non-itemizers*
Bladen	6,200 to 8,200
Chowan	2,900 to 3,500
Forsyth	68,600 to 73,800
Gaston	45,100 to 48,000
Guilford	92,000 to 98,900
Johnston	20,200 to 21,500
Mecklenburg	126,000 to 145,200
Wake	101,600 to 130,300

* Number of non-itemized returns by county. Source: N.C. Budget and Tax Center, 3/96.

Non-itemizers are often the very middle-income taxpayers who support the nonprofit organizations that enrich our communities. It's only fair to acknowledge them for being especially generous in investing in their communities -- just as those who itemize their deductions now are acknowledged through tax incentives. This will also help them get non-itemizers in the habit of keeping records of their charitable giving since they may qualify for a credit – whether they give to Charlotte's Crisis Assistance Ministry where Chairman McMahan volunteers, to Childcare Advocates for Response and Empowerment (CARE) in Rep. Daughtry's home county, to the Elizabethtown Rescue Squad in Rep. Nye's district, or to the United Way that Rep. Dickson supports in Gastonia.

- Reason 3: This encourages exceptional giving. With the floor set at 2% of income (the average level of giving in N.C.), this will acknowledge those who invest more than 2% of their own income in their communities. The N.C. Budget and Tax Center estimates that total itemized charitable deductions in 1995 will be just under 2% of the state's total personal income.

- Reason 4: **The projected $12.51 million in revenue foregone by the state will leverage $178.71 million in charitable investments in our communities**. This is a 1429% return on the state's money – an *extremely* profitable and wise investment of the state's resources. We urge you to recommend the highest incentive possible so you can make a real difference in increasing citizens' contributions to their communities across North Carolina. A 7% credit is modest, but it could boost current givers *and* stimulate new givers. We'd like to recognize and thank Chairman McMahan and the legislative staff for your fine work on this idea. Other states are *very* interested in what you are doing here in North Carolina to leverage significant *private investment* through a modest *public* tax incentive.



Recommendation 1 for increasing charitable giving (continued)

Following are examples of how this tax credit would work for taxpayers at different income levels.

EXAMPLE 1: For a family with an income of $40,000:

If they are average givers: If they give the North Carolina average of 2% of their income (or $800) in contributions:

If their total contributions are:	$800
A 2% floor would be 2% x $40,000 income:	- 800
Then the contributions to which the credit applies would be:	0
	x .07
Their 7% tax credit would be:	$0

If they are above average givers: If they respond to your tax credit incentive to increase their giving and give more than 2%, say they give 4% of their income (or $1,600) in contributions:

If their total contributions are:	$1600
A 2% floor would be 2% x $40,000 income:	- 800
Then the contributions to which the credit applies would be:	800
	x .07
Their 7% tax credit would be:	$56

If they are exceptional givers: If they're very generous and give 10% of income ($4,000) -- i.e., they tithe as I was taught to do – they probably itemize deductions, but if they're non-itemizers:

Total contributions:	$4000
A 2% floor would be 2% x $40,000 income:	- 800
Then the contributions to which the credit applies would be:	3200
	x .07
Their 7% tax credit would be:	$224

EXAMPLE 2: For a family with an income of $20,000:

If they are average givers: If they give 2% of their income ($400) in contributions:

Total contributions:	$400
2% floor would be 2% x $20,000 income:	- 400
Contributions to which credit would apply:	0
	x .07
7% tax credit would be:	$0

If they are above average givers: If they give 4% of their income ($800) in contributions:

Total contributions:	$800
2% floor would be 2% x $20,000 income:	- 400
Contributions to which credit would apply:	400
	x .07
7% tax credit would be:	$28

If they are exceptional givers: If they give 10% of their income ($2,000) in contributions:

Total contributions:	$2000
2% floor would be 2% x $20,000 income:	- 400
Contributions to which credit would apply:	1600
	x .07
7% tax credit would be:	$112

Recommendation 1 for increasing charitable giving (continued)

EXAMPLE 3: For a family with an income of $10,000:

If they are average givers: If they give 2% of their income ($200) in contributions:

Total contributions:	$200
2% floor would be 2% x $10,000 income:	- 200
Contributions to which credit would apply:	0
	x .07
7% tax credit would be:	$0

If they are above average givers: If they give 4% of their income ($400) in contributions:

Total contributions:	$400
2% floor would be 2% x $10,000 income:	- 200
Contributions to which credit would apply:	200
	x .07
7% tax credit would be:	$14

If they are exceptional givers: If they give 10% of their income ($1,000) in contributions:

Total contributions:	$1000
2% floor would be 2% x $10,000 income:	- 200
Contributions to which credit would apply:	800
	x .07
7% tax credit would be:	$56

Nonprofits are under such pressure now because of rising demand for their services just when fewer and fewer dollars are available. Every day in working with nonprofits across the state, I see wonderful examples of their resourcefulness and ingenuity in the face of limited resources. This tax credit recommendation is an important step in leveraging *private* resources to help them serve our communities. It could help the YWCA in Rep. Bowie's district, the Edenton-Chowan Food Pantry in Rep. Culpepper's district, service organizations supported by Skip Stam's church in Apex, and the foundations led by Henry Carter, Bill Spencer, and Ed Ellis.

Fortunately, however, though nonprofits in North Carolina are very resourceful in working toward their missions despite limited funds, they have not taken the approach that a nonprofit zoo in another state has taken. A friend of mine told me about ... (tell story).

Recommendation 2 for increasing charitable giving:

Eliminate the sales tax on goods donated to charitable nonprofits by businesses.

Why?

- Reason 1: This eliminates a current *disincentive* for businesses to donate goods to the community. Under current federal and state law, businesses have an incentive to donate cash to nonprofits. However, they have a disincentive to donate goods like computers, furniture, supplies, or clothing because they get taxed on these goods. This recommendation would eliminate that disincentive.

- Reason 2: This will not cost much, if anything. Most businesses do not know they are supposed to pay sales and use tax on goods they donate to the community, so the state does not currently collect much, if any, revenue on this. The $600,000 fiscal note is really theoretical revenue because this is *not* money the state is collecting now. And even *if* the state *were* collecting this 6% tax now, the $600,000 revenue loss would still leverage $10 million in charitable goods donated to the community – an outstanding investment of state resources. But I repeat, unlike the first recommendation for a tax credit, this one does not involve real revenue loss so the Committee can help increase charitable donations of goods with this recommendation without real revenue loss to the state.

Earlier, I introduced to you Kate McGuire from the N.C. Center for Nonprofits. Kate used to work at the Food Bank of N.C., where she arranged for F.F.M., the supplier for Hardees, to donate chili to the Food Bank which then provided 4,300 meals for needy families in Goldsboro alone. This is an example of the difference that donated goods can make.

Recommendation 3 for increasing charitable giving:

Increase the state business income tax deduction for charitable contributions from 5% of taxable income to correspond to the federal limit of 10% of taxable income. Also adopt the federal provision allowing businesses to carry forward to future years any contributions that exceed the 10% federal limit.

Why?

- Reason 1: This makes the state tax laws consistent with the federal laws and thus makes them easier for businesses to understand. This also gives business the right message: that North Carolina is friendly to good corporate citizens who contribute generously in their communities. North Carolina's current limit of 5% of taxable income with no option to carry forward the excess contributions to future years is more restrictive than the federal limit of 10% of income with the option to carry forward the excess.

- Reason 2: This helps small business. Small businesses often operate on a small profit margin and their net income may thus be small, but they do give above 5% more often than large companies, so this could help them by removing a disincentive for giving.

For example, Rep. Bowie's friend David Grimes, who owns Potpourri Press in Greensboro, is very involved in the community. This change would help him because he could deduct 10% of his company's taxable income on his state return just as he can on his federal return.

SECOND GOAL: Cut government red tape for nonprofits.

The N.C. Center for Nonprofits has worked with the Attorney General's office, the legislative staff, and Chairman McMahan to develop the following two recommendations. Neither will result in a revenue loss for the state.

Recommendation 1 for cutting government red tape:

Shorten the licensure statement required in the Charitable Solicitations Act for nonprofits that raise funds in North Carolina. Also allow more ways to highlight the statement.

Why?

- <u>Reason 1: This would shorten the unnecessarily long statement that's currently required</u>.
- <u>Reason 2: This would make it more feasible for nonprofits to comply</u>.

Recommendation 2 for cutting government red tape:

Eliminate the need to submit the *very* same information twice when applying for a license to raise funds under the state's Charitable Solicitations Act.

Why?

- <u>Reason: This would eliminate unnecessary duplication</u> by eliminating the need to submit the *very* same information twice in different formats, thus reducing paperwork for nonprofits *and* the state. This would not eliminate any of the information actually provided by the nonprofit.

Other concerns about government red tape for nonprofits

Nonprofits across the state have consistently told us of two other types of red tape that cause them to incur unnecessary costs. We were not able to develop specific recommendations for these in time for this testimony, but I want to tell you of these two problems anyway in case you want to try to address them now or in the future.

The first problem is that nonprofits are finding a lot of red tape and required duplication of several of the steps in the state's contracting process. We would support any reasonable and appropriate changes that would cut red tape in the state contracting process.

The second problem is that nonprofits that receive state funds to deliver government-supported services – which is about 7% of all charitable nonprofits in North Carolina – are incurring considerable *extra* costs on their audits done by independent CPAs. This is because of the State Auditor's requirement that any organization that receives $25,000 or more in state funds – or federal funds passed through the state – must get a CPA firm to add *special* procedures to its *regular* procedures for an independent audit.

Nonprofits are finding it more and more difficult to find CPAs who have the special training to do these additional audit procedures which go beyond regular audit practices. *If* they can find a CPA qualified and willing to do these procedures, the cost of the audit generally goes up 25-50% because of the extra -- and expensive -- time required for the CPA.

In *addition* to the audit required in the statutes *and* the added procedures now required by the State Auditor, some departments *also* require the additional, extra "A133" federal audit procedures which are even more expensive. The federal government, on the other hand, only requires this A133 audit for nonprofits that receive $100,000 or more in federal funds.

Under the goal of cutting red tape, we would be supportive of any reasonable and appropriate measures that can cut these extra costs incurred by nonprofits that receive state funds. Perhaps you could look at raising the $25,000 threshold or suggesting the removal of the requirement for these *extra* audit procedures for nonprofits that receive less than $100,000 in state funds. A $100,000 threshold would be consistent with the federal threshold for nonprofits that receive federal funds.

In Closing

In closing, I'd like to thank you again, Chairman McMahan, for inviting the N.C. Center for Nonprofits to present these recommendations from nonprofit organizations across the state. I would be glad to respond to questions now. Kate McGuire and I will be here throughout your meeting today in case we can be of assistance to the Committee.

Summary of Recommendations

to the N.C. House Select Committee on Nonprofits
from the N.C. Center for Nonprofits, March 14, 1996

A. To Increase Charitable Giving

1. Create a 7% tax credit for charitable contributions given by North Carolinians who do not itemize on their federal tax returns (and who thus are not currently allowed to deduct their charitable contributions on their federal *or* state returns). We recommend using a floor of 2% of taxable income because 2% is the average percentage of their income that North Carolinians contribute to nonprofits. A 2% floor would thus acknowledge and encourage giving that is *above* the average. So non-itemizers would get a 7% tax credit on their total donations that *exceed* 2% of their income.

2. Eliminate the sales and use tax on goods donated to charitable nonprofits by businesses.

3. Increase the state business income tax deduction for charitable contributions from 5% of taxable income to correspond to the federal limit of 10% of taxable income. Also adopt the federal provision allowing businesses to carry forward to future years any contributions that exceed the 10% federal limit.

B. To Cut Red Tape for Nonprofits

1. Shorten the licensure statement required in the Charitable Solicitations Act for nonprofits that raise funds in North Carolina. Allow more options for ways to highlight the statement.

2. Eliminate the need to submit the same information twice in the materials currently requested from nonprofits under the Charitable Solicitations Act.

APPENDIX G

DO TAX INCENTIVES MAKE A DIFFERENCE?

by

Richard Bostic
Senior Fiscal Analyst, Fiscal Research Division

IV. A.

Do Tax Incentives Make a Difference?

Presentation to the House Select Committee on Non-Profits
March 14,1996

Prepared by Richard Bostic
Fiscal Research Division

Do Tax Incentives Make a Difference?

Do tax incentives make a difference in charitable giving? The answer is yes for federal taxes based on detailed economic research. Of course, the impact varies based on an individual's income and whether they itemize their charitable expenses. The answer for state tax incentives is probably not. I could not find any literature on the effects of state taxes on giving. The state tax is so small that it does little to reduce the price of giving.

Most of my remarks today will be taken from the work of a former professor of mine, Duke University's Dr. Charles Clotfelter. Dr. Clotfelter literally wrote the book on taxes and giving in 1985 entitled "Federal Tax Policy and Charitable Giving". I regret that he could not speak with you today, but I will do my best to summarize some of the key points of his work.

Why do people give to charitable organizations? A 1973 survey by the Commission on Private Philanthropy and Public Needs asked persons who gave $100 or more "Why did you give to this organization?" (p.35) Their responses were as follows:

67%	Approve, They need money, Feel obligated
23%	Belongs
13%	Get some benefit
5%	Pressure, quota
13%	Other

In the first category, "they need money", community (77%) and social welfare (77%) ranked highest in the responses. In the "belongs" category, religious organizations (44%) were mentioned most with cultural (8%) and community (8%) second. The individual belongs to the organization named. Those who feel they "get some benefit" mentioned higher education (44%) most. Those responding that they gave under "pressure" were referring to a combined campaign (25%).

In this same survey, fewer than half of the households said they thought the charitable deduction stimulated giving, but over 70% of those with incomes over $50,000 believe that the tax deduction spurs giving.(p.33) (Note: In 1993, 70.7% of all returns took the standard deduction, so the majority of taxpayers do not itemize to take advantage of the charitable deduction.)

An article by Jeffrey Obler in the British Journal of Political Science (1981) explained that giving is driven by three basic motivations - altruism, reciprocity and direct benefit. These motivations are linked with an economic view of an individual's utility. Utility means welfare, well being or satisfaction.

1) Altruism - Giving is an economic good that is as valued as an individual's own consumption. Social norms and social pressure also create altruistic behavior by increasing a person's utility by the act of making contributions.

2) Reciprocity - This idea assumes people act charitably for the same reason they buy insurance: giving brings the benefit of potential return aid.
3) Direct Benefit - Persons may give so that they or their family may consume services.

Dr. Clotfelter wrote that "...the income tax deduction is probably the most important single tax policy affecting the vitality of the nonprofit sector in the United States. By reducing taxable income and thus tax liability, the deduction has the effect of lowering the net cost of making donations". (p. 25) The deduction was approved in 1917 to encourage continued charitable giving in the face of high wartime tax rates.

Economic studies have proven that changes in the federal tax code have an impact on charitable giving. Clotfelter cites 16 econometric analyses of charitable contributions in the U.S. (p. 57-60). Each study measures how tax affects the <u>price</u> of giving and net <u>income</u>. Although the estimated results vary due to the source and year of the data and to sample size, the final conclusion is the same:

1. As the net price of giving increases, the amount given in contributions decreases. (For example, as the marginal tax rate increases for itemizers, the lower the price of donating.)

2. As net income increases, so do contributions increase.

Martin Feldstein wrote that the income tax reduces all forms of philanthropy by decreasing disposable income. However, because contributions are deductible in determining taxable income, the tax makes the price of giving less than the price of other goods and services. (National Tax Journal, March 1975)

Dr. Clotfelter wrote a chapter in his book on simulating the effects of tax policies. Using data from the 1983 tax year, several proposals were tested for their impact on contributions. (p. 126)

1. 150% deduction = 41.5% increase in giving

2. graduated deduction (sliding scale with lowest incomes receiving a 200% deduction) = 4% increase

3. Extend deduction to non itemizers = 12.6% increase

4. Eliminate deduction = 26.2% decrease

5. Substitute 20% tax credit for deduction = 4% decrease

6. Substitute 30% tax credit for deduction = 11.7% increase

7. Flat-rate tax on taxable income = 11.8% decrease

A Price Waterhouse study said the elimination of the deductibility of contributions would reduce charitable giving by $20 billion in 1992. On the otherhand, if contributions had been deductible for non-itemizers, charitable giving would have increased $3 billion.

Three of the tax proposals were tested against income levels:

1. Elimination of Deduction -

   As income rises, the percentage change in giving declines at a greater rate. For example, a person with an income between $6,100 and $12,200 would give 3% less if the deduction were eliminated while a person with an income of $36,500 to $60,900 would give 33.6% less (p. 130)

2. Flat Rate on Taxable Income -

   As income rises, giving declines at a ever increasing percentage.

3. Graduated Multiple Deduction-

   For incomes under $30,400, giving increases. For incomes over $30,400, the rate of giving declines but at a small .1% to .3%.

Simulations were also run on giving by type of organization:

1. Extension of deduction to non itemizers -

   Religious organizations benefit the most and cultural organizations gain the least.

2. Elimination of deduction -

   Religious organizations are hurt the least, while educational and cultural are hurt the most.

3. Tax Credits -

   Religious organizations gain, while all others lose funding.

Martin Feldstein found that gifts to educational institutions and hospitals are very sensitive to the cost of giving while religious organizations are much less sensitive. Substituting a tax credit for the tax deduction, reduces contributions to educational institutions and hospitals, but increases contributions for churches and health and welfare organizations. (National Tax Journal, June 1975)

In a chapter of Do Taxes Matter?, (1981) edited by Joel Slimrod, Dr. Clotfelter looked at the tax changes in the early 1980's.

1. Tax rate cuts in 1981 and 1986 caused a drop in giving in the upper income levels by more than was predicted.

2. In 1985 and 1986, a deduction applied to all non itemizers. Average giving for non itemizers rose over the period in a manner consistent with all economic models.

Having said all this, those motivated by tax law to give, will do so by the federal tax changes and likely not the state. The state tax is so small that it probably would not reduce the price of giving enough to increase donations.

Table 2.10 **Reasons for Giving, by Donee Organization, 1973**[a]

Type of Organization	Approve, They Need Money, Feel Obligated	Get Some Benefit	"Belongs"	Pressure, Quota	Other, DK, NA	Number of Gifts
Religious	69%	8%	44%	2%	6%	1,649
Combined	66	4	2	25	15	750
Community, other	77	21	8	3	14	480
Health	53	27	2	6	24	686
Higher education	66	44	3	2	19	441
Other education	74	29	2	0	17	133
Social welfare	77	13	2	1	16	293
Cultural	75	21	8	0	12	107
Overall averages and total	67%	13%	23%	5%	13%	4,539

Source: Morgan, Dye, and Hybels 1977, p. 204, table 34.

[a]Numbers are sums of percents of first and second mentions for each reason among those who gave $100 or more in 1973. Percentages are based on gifts to various donee organizations, not dollars of giving. The question posed was: Why did you give to this organization?

Table 3.7 Simulation Totals for 1983: Revenue, Price of Giving, Contributions

Tax Law or Proposal	Revenue Adjustment	Average Price of Giving[a]		Contributions (billions)	
		Itemizers	Nonitemizers	Constant Elasticities	Variable Elasticities
1983 law	—	0.74	1.00	$45.1	$45.2
Expansion of the charitable deduction					
150 percent multiple deduction	1.07	0.62	1.00	63.8	66.8
Graduated multiple deduction	1.01	0.69	1.00	46.9	46.1
Extension to nonitemizers	1.02	0.74	0.86	50.8	48.6
Limitation of the charitable deduction					
Constructive realization on gifts of appreciated assets	1.00	0.74	1.00	44.3	44.5
Elimination of deduction	0.97	1.00	1.00	33.3	36.1
Substitution of tax credit for deduction					
20 percent	1.00	0.81	0.86	43.3	42.2
30 percent	1.02	0.72	0.79	50.4	46.4
Flat-rate tax					
On taxable income (20.7%)[c]	—	0.80	1.00	39.8	40.7
On adjusted gross income plus excluded long-term gains (13.6%)[c]	—	1.00[b]	1.00	33.0	36.0

[a]Weighted by number of returns.

[b]There is no distinction between itemizers and nonitemizers under this proposal.

[c]Tax rates shown in parentheses are after revenue adjustment. Original tax rates were 19.5 and 11.8 percent for the last two simulations. Calculated revenue adjustment factors were 1.06 and 1.15.

Table 3.9	Distributional Effects of Tax Changes: Illustrations for Three Tax Proposals (percentage change compared to 1983 law)					
Income (thousands)	Elimination of Deduction		Flat Rate on Taxable Income		Graduated Multiple Deduction	
	Income	Giving	Income	Giving	Income	Giving
$0 under 6.1	0	0	0	0	0	0
$6.1 under 12.2	+0.2	−3.0	−3.8	−0.5	0	+3.0
$12.2 under 18.3	+0.2	−9.2	−3.8	−0.2	+0.2	+13.4
$18.3 under 24.3	+0.2	−13.0	−3.2	−2.1	+0.1	+7.9
$24.3 under 30.4	+0.1	−17.5	−2.7	−2.7	+0.2	+14.3
$30.4 under 36.5	0	−24.3	−1.6	−9.0	−0.1	−0.1
$36.5 under 60.9	−0.1	−33.6	+0.2	−14.3	−0.1	−0.1
$60.9 under 121.7	−0.2	−51.0	+5.7	−31.8	−0.1	−0.1
$121.7 under 243.4	−0.1	−59.5	+13.1	−38.0	−0.2	−0.2
$243.4 under 608.5	−0.3	−62.8	+17.7	−38.2	−0.2	−0.3
$608.5 under 1217	−1.0	−64.5	+19.7	−38.3	−0.2	−0.3
$1217 or more	−1.5	−65.4	+20.9	−38.2	−0.2	−0.3
TOTAL	0	−26.1	0	−11.8	0	+3.9

Note: Simulations use constant-price elasticity of − 1.27 and income elasticity of 0.78.

Table 3.10 Simulated Long-Run Changes in Giving by Type of Organization, as Percentage of 1983 Levels

Percentage Difference from 1983 Law	Total	Religious	Educational: Higher	Educational: Other	Combined Appeals	Medical	Cultural	Other
150 percent deduction	+42	+23	+154	+117	+71	+73	+169	+74
Graduated multiple deduction	+4	+5	+1	0	+2	+3	0	+2
Extension to nonitemizers	+13	+14	+8	+8	+11	+11	+7	+11
Constructive realization on gifts of appreciated assets	−2	−1	−7	−6	−3	−3	−8	−3
Elimination of deduction	−26	−21	−50	−52	−36	−34	−58	−37
20 percent tax credit	−4	+2	−35	−37	−16	−14	−44	−18
30 percent tax credit	+12	+19	−24	−25	−1	0	−34	−4
Flat tax on taxable income	−12	−8	−30	−31	−19	−18	−36	−19
Flat tax on adjusted gross income plus excluded long-term gains	−27	−23	−46	−47	−34	−33	−51	−35

Note: Simulations use constant-price elasticity of −1.27 and income elasticity of 0.78.

Table 3.11 **Estimates of Giving Implied by Two Distributions of Giving by Type of Organization**

	Level of Contributions, 1983 ($billions)	Percentage Change in Contributions from 1983 due to: Extension of Deduction to Nonitemizers	20 Percent Tax Credit	Flat tax on Taxable Income
Distribution Based on National Study of Philanthropy				
Religious	$32.89	+14	+2	−8
Educational				
Higher	1.98	+8	−35	−30
Other	0.66	+8	−37	−31
Combined appeals	2.56	+11	−16	−19
Medical	2.52	+11	−14	−18
Cultural	0.60	+7	−44	−36
Other	3.69	+11	−18	−19
TOTAL	45.09	+12	−4	−12
Distribution Based on Tabulation of 1962 Tax Returns				
Religious	27.89	+13	+1	−9
Other charitable	6.47	+13	−6	−13
Educational	1.57	+9	−30	−27
Hospitals	0.64	+9	−30	−27
Other organizations	8.47	+12	−11	−16
TOTAL	45.09	+13	−4	−12

APPENDIX H

CHARITABLE CONTRIBUTIONS AND THE TAX CODE

by

John Hood
President, John Locke Foundation

John LOCKE FOUNDATION

Comments of

John Hood, President

John Locke Foundation

on

"Charitable Contributions and the Tax Code"

March 14, 1996

Thank you for the opportunity to speak on this important topic, which has a bearing not only on North Carolina's tax code but also on the division of responsibilities between the for-profit sector, the public sector, and the non-profit sector. As I understand that you have already heard from numerous people about the relationship between tax incentives and charitable contributions, I'm going to make my formal comments relatively brief and then leave time for your specific questions.

From what I have read in prior testimony and commentary on this issue, you have heard that the current tax deduction for charitable contribution is tremendously important in maximizing contributions, and that further deductions for giving of money, in-kind assistance, and volunteered time might significantly strengthen the finances of nonprofit organizations in North Carolina. I disagree with this assessment, for several reasons.

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First, if you look historically at charitable giving in the United States, you will see the the percentage of income given to nonprofits hasn't changed much in recent years. From 1963 to 1993, for example, the share of gross domestic product given to charities stayed within a narrow band of 1.7 percent (1978) to 2.2 percent (1963). For about a decade, the percentage has been exactly the same — 2 percent. Keep in mind that this was a period in which marginal tax rates, and thus the real value of the tax deduction for charitable contribution, changed significantly.

Of course, the fact that the share of GDP going to charities hasn't changed much in three decades is not to say that the aggregate numbers haven't changed. Two percent of a growing economy is a lot more money than two percent of a stagnant or recessionary economy. Indeed, total giving adjusted for inflation rose by about 80 percent during this 30-year period, to $126 billion in 1993. When you look at the line graph of inflation-adjusted contributions, you will see that the line goes up when the economy is growing and then often levels off or declines during periods of recession. In other words, cash flow to nonprofits do depend significantly on the performance of the economy as a whole, which shouldn't be surprising.

Don't take my word for this relationship. Studies by Dan Mitchell of the Heritage Foundation and many other groups show that if anything, tax rates matter more than tax deductions in maximizing charitable contributions. In particular, the period of the 1980s, when the top marginal rates was reduced from 70 percent to 28 percent, has been extensively studied for its lessons on charitable contributions. The result, as summarized by economist Richard B. McKenzie, is that individual giving in the 1980s was well above what one would expect from most statistical models. The reasons for this include an overestimation of how much the deduction matters, an underestimation of

how much economically stimulative tax rates matter, and the possibility that other factors, such as the reaction of charities to potential tax changes and changing demographics, matter more than either.

So we have a disagreement between two views on how the tax code might affect charitable contributions. One is that the deduction matters more than the economic stimulus of lower tax rates. The other is the reverse — that stimulative tax rates matter more than the deduction. I believe the second proposition, but there is a third one that we should consider, what some economists call the "crowd-out" effect.

When we talk about tax incentives for charitable contributions, we forget that no individual gives to charity just to get a deduction. That would be absurd — spending a dollar to save a quarter. Instead, people donate to accomplish certain objectives or support certain causes. The presence of a tax deduction, or the presence of more money in your pocket after tax cuts, will only affect how much money on the margin you are willing to give. It is unlikely to determine your propensity to give. But what if you perceive that the objective or cause you are thinking about supporting will be sufficiently supported by others? If so, then neither a deduction nor more after-tax income will be enough of an incentive for you to give. You can safely buy something for yourself or save your money, based on the comforting assumption that your objective or cause will be fine without you.

Government can affect this incentive to give by providing direct subsidies to nonprofits or by running programs or services instead of nonprofits. So, for example, a museum that operates primarily on government funds is necessarily able to make less of a dramatic pitch for private donations than another museum wholly dependent on private contributions. Similarly, if taxpayers believe that they already pay significant sums for education, health

care, or services for the poor, then they are likely to be less willing to donate money or time to these needs.

A historical example of the crowd-out effect might be found in human services. Since the early 1960s, governments at both the federal and state levels have dramatically expanded their role in providing income support, paying health care bills, and performing other human services. At the same time, the percentage of charitable giving devoted to health and human services has declined, from 28 percent in 1963 to about 20 percent in 1993.

One might also look at private education. Parents of students in private-school are more likely to volunteer their time at the school or in extracurricular activities that parents of public-school kids. This is true even for private schools catering to middle- and lower-income people, such as Catholic schools. The difference may be partly the power of choice itself, which binds a parent more closely to a school that he or she has actively chosen. But it may also reflect the tendency for people to devote their time and resources to needs that they perceive to be great and that will not be sufficiently met without their help.

Let me summarize. The tax deduction for charitable contributions does, in fact, reduce the cost of giving to charities by some amount. That amount is determined not only by the size of the allowed deduction but also by the size of the marginal income tax rate. As you cut the rate, therefore, you also cut the value of the deduction. However, cutting the rate also gives people more after-tax money to spend, which generates greater economic activity and thus increases charitable contributions. Economists agree that both reducing the cost of giving through deductions and increasing economic activity through lower rates can have beneficial effects on charitable giving, but the relative magnitude of those effects isn't clear. If anything, it seems that economic

stimulus may be more important, especially in the long run, than reducing the cost through deductions.

Finally, government affects charitable contribution not only through tax policy but also through expenditure policies. To some degree, nonprofits compete with governments in the minds of potential givers, so they are less likely to give to causes that already receive substantial government funding or to programs that are government-run.

My own view is that North Carolina and the United States should reform its tax code to maximize economic growth. That means moving towards a flat income tax that eliminates most deductions and lowers rates accordingly. To address the crowd-out problem, I would like to see us create a dollar-for-dollar tax credit, not a deduction, for giving to nonprofits engaged in certain activities that are currently dominated by less-effective government programs, such as welfare. These are incentives for charitable contribution that I believe promise tremendous social benefits. I do not believe such benefits will accrue from expanded tax deductions. Thank you.

Suggested Readings:

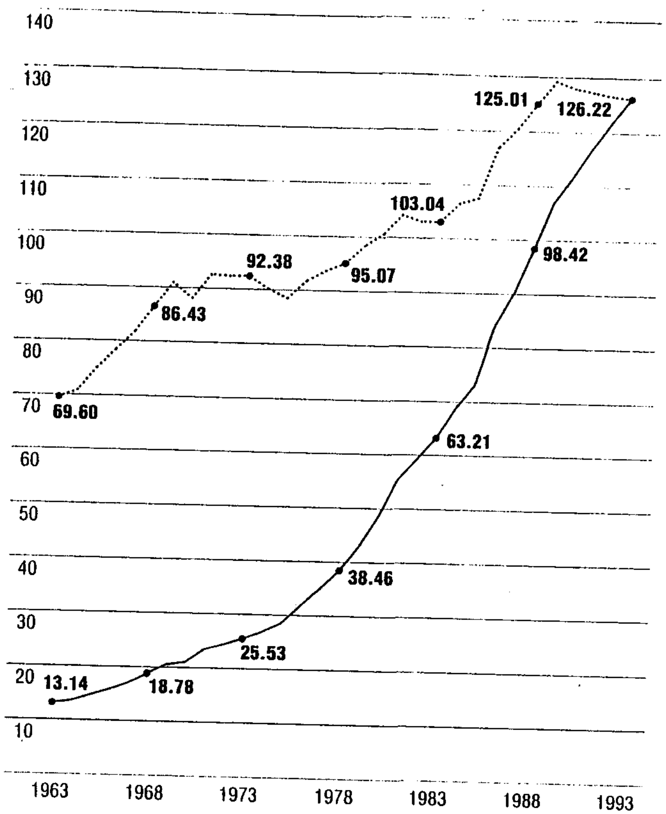
• Eliot Jamison, "The Flat Tax and Charity: Is There a Conflict?" *Alternatives in Philanthropy*, Capital Research Center, Washington, D.C., October 1995.

• Ann E. Kaplan, editor, *Giving USA 1994*, 39th Annual Issue, AAFRC Trust for Philanthropy, New York, N.Y., 1994.

• Daniel J. Mitchell, "Jobs, Growth, Freedom, and Fairness: Why America Needs a Flat Tax," Backgrounder No. 1035, The Heritage Foundation, Washington, D.C., May 25, 1995.

Total Giving 1963-1993

($ in Billions)



—— Current $
.... Inflation-Adjusted $

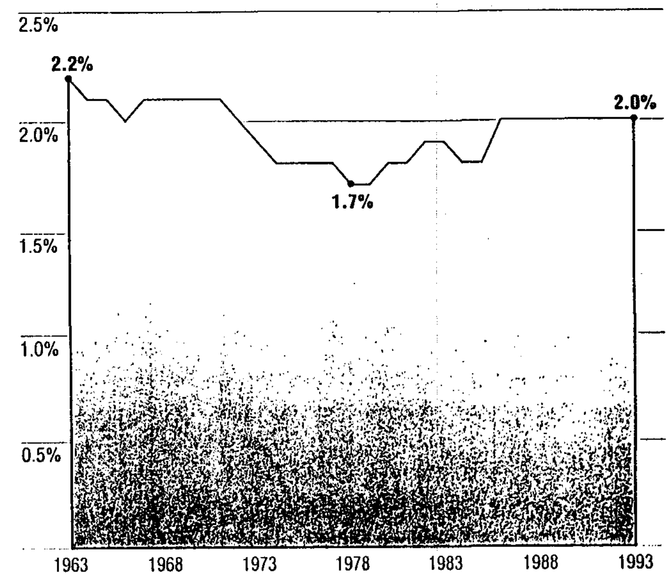
Total Giving 1982-1993 ($ in billions)

	Current $	Inflation-Adjusted $		Current $	Inflation-Adjusted $
1982	$59.19	$103.02	**1988**	98.42	125.01
1983	63.21	103.04	**1989**	107.03	129.20
1984	68.78	106.51	**1990**	111.89	127.99
1985	73.15	107.55	**1991**	117.10	127.30
1986	83.88	117.01	**1992**	121.89	126.63
1987	90.27	120.51	**1993**	126.22	126.22

From Giving USA 1994

Giving as a Percent of Gross Domestic Product 1963-1993

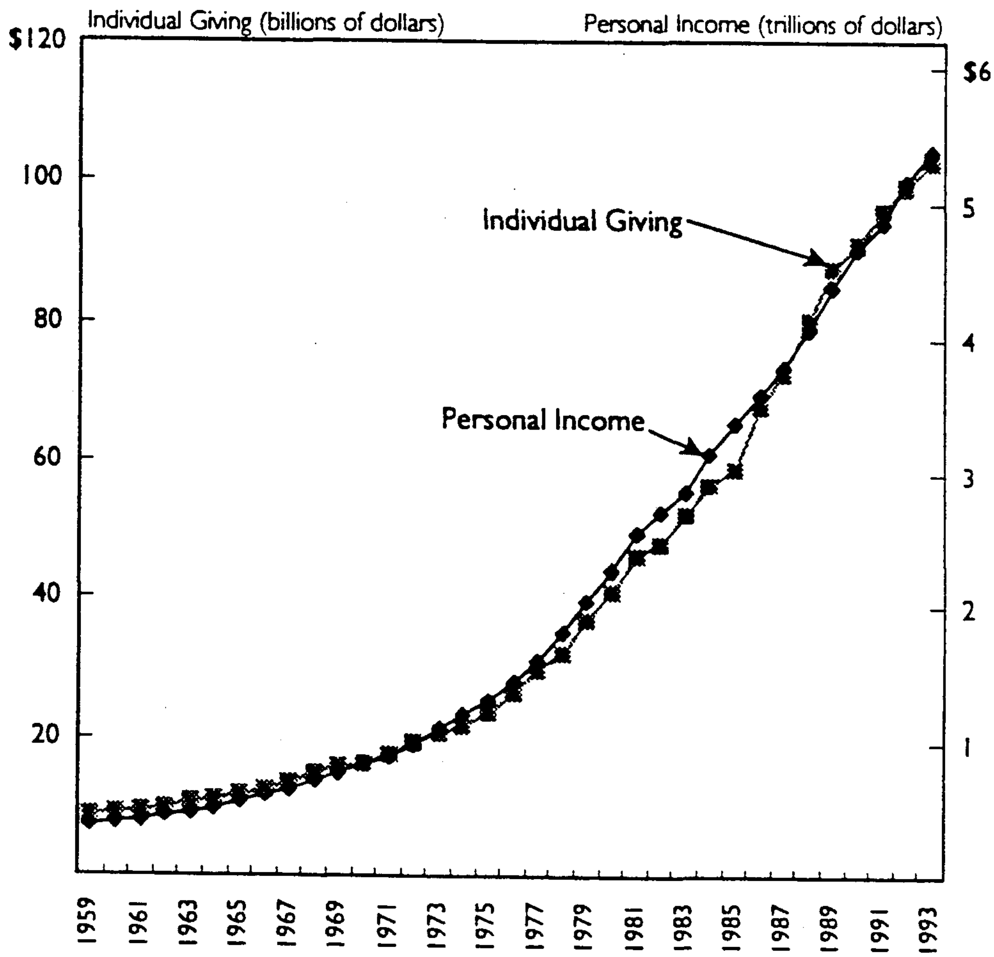
(% of GDP)



Giving as a Percent of Gross Domestic Product 1963-1993 ($ in billions)

	Total Giving	GDP	Giving as a % of GDP		Total Giving	GDP	Giving as a % of GDP
1963	$13.14	$ 603.1	2.2%	**1979**	42.96	2,488.6	1.7%
1964	13.60	648.0	2.1%	**1980**	48.55	2,708.0	1.8%
1965	14.67	702.7	2.1%	**1981**	55.31	3,030.6	1.8%
1966	15.78	769.8	2.0%	**1982**	59.19	3,149.6	1.9%
1967	17.02	814.3	2.1%	**1983**	63.21	3,405.0	1.9%
1968	18.78	889.3	2.1%	**1984**	68.78	3,777.2	1.8%
1969	20.57	959.5	2.1%	**1985**	73.15	4,038.7	1.8%
1970	21.04	1,010.7	2.1%	**1986**	83.88	4,268.6	2.0%
1971	23.43	1,097.2	2.1%	**1987**	90.27	4,539.9	2.0%
1972	24.42	1,207.0	2.0%	**1988**	98.42	4,900.4	2.0%
1973	25.53	1,349.6	1.9%	**1989**	107.03	5,250.8	2.0%
1974	26.82	1,458.6	1.8%	**1990**	111.89	5,546.1	2.0%
1975	28.49	1,585.9	1.8%	**1991**	117.10	5,722.9	2.0%
1976	31.75	1,768.4	1.8%	**1992**	121.89	6,038.5	2.0%
1977	35.08	1,974.1	1.8%	**1993**	126.22	6,379.4	2.0%
1978	38.46	2,232.7	1.7%				

Charitable Giving Closely Tied to Income Growth



Source: Economic Report of the President; Independent Sector.