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EXILE TO MAIN STREET: THE I.R.S.'S DIMINISHED ROLE IN OVERSEEING TAX-EXEMPT ORGANIZATIONS

EVELYN BRODY¹ AND MARCUS OWENS²

INTRODUCTION

The Chicago-Kent conference on charity oversight took place on Day 924 of the TaxProf blog's "IRS Scandal"³—Day 1 being the Friday two-and-a-half years ago that the U.S. Internal Revenue Service's Lois Lerner apologized for inappropriate use of Tea Party and other names in selecting applicants for Internal Revenue Code § 501(c)(4) status for further review.⁴ This article examines the IRS's role in administering the regime for federally tax-exempt organizations. Our focus, however, should not obscure the very real corrosive impact, whether deserved or pretextual, that the IRS's exempt-organization imbroglio has had on the health of the entire agency, and thus to the revenue needs of the federal government.⁵

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2. Partner, Loeb & Loeb LLP, Washington, DC, and former Director, Exempt Organizations Division, Internal Revenue Service.

3. See Paul Caron, *The IRS Scandal, Day 883*, TAXPROF BLOG (Oct. 9, 2015), http://taxprof.typepad.com/taxprof_blog/2015/10/the-irs-scandal-day-883.html#comments (linking to Peter Reilly's October 7 and 8, 2015 postings on *Forbes* entitled "Paul Caron's Day by Day IRS Scandal Has Jumped the Shark."). Close observers will note that the seeds of the "scandal" were sown as early as 2003 when the IRS significantly reduced technical training for Exempt Organizations employees and accorded much greater authority to the Cincinnati field office to handle tough cases. Then, in 2011, the IRS demonstrated that it was vulnerable to politically-motivated pressure when the Deputy Commissioner for Services and Enforcement, Steven Miller, acquiesced to pressure from Republican members of Congress and abruptly terminated five gift tax audits of wealthy donors who contributed to social welfare organizations, an extraordinary intervention in on-going IRS field work by the Commissioner's senior staff. See, e.g., David van den Berg, *IRS Halts Gift Tax Exams of 501(c)(4) Donors*, 132 TAX NOTES 118 (2011). Note that § 408 of the Protecting Americans from Tax Hikes Act of 2015, Pub. L. No. 114-40 (Dec. 18, 2015) (codified as amended at I.R.C. § 2501(a)), provides that the gift tax does not apply to gifts made to organizations exempt from tax under §§ 501(c)(4), 501(c)(5), or 501(c)(6).

4. Paul Caron, *IRS Admits to Targeting Conservative Groups in 2012 Election*, TAXPROF BLOG (May 10, 2013), http://taxprof.typepad.com/taxprof_blog/2013/05/irs-admits.html. All section references are to the Internal Revenue Code of 1986, as amended (the "Code"), and all regulatory references are to the Treasury Regulations currently in effect under the Code.

5. See Letter from Seven Former Comm'rs of Internal Revenue to House and Senate Appropriations Leadership (Nov. 9, 2015), http://taxprof.typepad.com/taxprof_blog/2015/11/seven-former-irs-commissioners-call-for-restoring-cuts-in-the-irss-budget.html ("Over the last fifty years we served during the administrations of Presidents John F. Kennedy, Lyndon B. Johnson,

The IRS—an agency which in the best of times suffers from a siege mentality—is now starved for resources both financial and political. The IRS has predictably and understandably responded to the “scandal” by retreating into a shell of bureaucratic reshuffling, management mumbo-jumbo, and paper moving. There has never been a better time to apply for tax-exempt status or push the boundaries of permissible activities.

Will the IRS’s decision to exile the Exempt Organization Division from Washington, D.C. to Cincinnati save the agency as well as the exempt-organization function by removing its operations from the glare of Washington’s perpetual partisan politics? Or will this attempt to jettison the albatross from the sinking ship instead stifle the effectiveness of the IRS’s role in charity and nonprofit oversight, suggesting—as co-author Marcus Owens has written about at length⁶—the need for a new and independent agency to carry out that role?

This article proceeds in three parts. Part I describes the framework for federally tax-exempt organizations engaged in advocacy and political activity, and recites the sorry saga of the recent unpleasantness. Part II summarizes the IRS’s managerial reaction. Part III focuses on the IRS’s new procedure for granting speedy recognition of tax-exemption to new small charities—perhaps setting the agency up for the next debacle. Our conclusion sets out the not-so-great choices, mindful that the goal is to avoid making the wrong mistake.⁷

Ronald Reagan, George H.W. Bush, William J. Clinton, and George W. Bush The appropriations reductions for the IRS over the last five years total \$1.2 billion, more than a 17% cut from the IRS appropriation for 2010. None of us ever experienced, nor are we aware of, any IRS appropriations reductions of this magnitude over such a prolonged period of time.”). In the December 2015 budget deal the IRS escaped with the same base funding as last year plus an additional \$290 million for taxpayer services, anti-fraud measures, and cybersecurity. See H. R. COMM. ON APPROPRIATIONS, 114TH CONG., FY 2016 OMNIBUS – FINANCIAL SERVICES APPROPRIATIONS (2015), https://appropriations.house.gov/uploadedfiles/12.15.15_fy_2016_omnibus_-_financial_services_-_summary.pdf.

6. Marcus S. Owens, Caplin & Drysdale, *Charity Oversight: An Alternative Approach*, Presented at Columbia Law School, National State Attorneys General Program, Charities Regulation and Oversight Project’s 2013 Charities Regulation Policy Conference, The Future of State Charities Regulation and Enforcement (Feb. 7–8, 2013).

7. See *Yogi Berra Quotes*, BASEBALL ALMANAC, <http://www.baseball-almanac.com/quotes/quoberra.shtml> (last visited Mar. 27, 2016) for the famous Yogi Berra quote “[w]e made too many wrong mistakes.”

I. CONSEQUENCES OF INADEQUATE LEGAL STANDARDS FOR A SENSITIVE AGENCY FUNCTION

A. Historical Rhythm of Government/Exempt Organization Relations

Government oversight of nonprofit and tax-exempt organizations has been part of many significant developments in American history. The role of state attorneys' general in regulating charities is beyond the scope of this article.⁸ However, the starting point for both state and federal oversight traces back to the Statute of Charitable Uses (1601): The Statute of Elizabeth's preamble listing of charitable purposes echoes in today's Treasury Department Regulations.⁹

The modern federal oversight structure formally dates to the Tax Reform Act of 1969 and the Employee Retirement Income Security Act of 1974, but all U.S. income-tax statutes, starting after the Civil War, have exempted charities.¹⁰ In the 1940s, the Internal Revenue Service began to require exempt organizations (excluding churches) to file an annual information return: the Form 990.¹¹ A few years later, Congress enacted the "unrelated business income tax" in the wake of aggressive commercial exploitation.¹² The Revenue Act of 1950 also made the Form 990 a public document.¹³

Following the landmark Supreme Court decision in *Brown v. Board of Education*, the IRS found itself playing a central role in federal efforts to combat racial segregation.¹⁴ By the 1970s, the IRS faced a permanent injunction against continuing to recognize racially-discriminatory private schools in Mississippi as tax exempt; vindication of subsequent

8. See Evelyn Brody, *The Legal Framework for Nonprofit Organizations*, in THE NONPROFIT SECTOR: A RESEARCH HANDBOOK 243, 243-66 (Richard Steinberg & Walter W. Powell eds., 2d ed. 2006); Evelyn Brody, *Whose Public?: Parochialism and Paternalism in State Charity Law Enforcement*, 79 IND. L.J. 937 (2004); Linda Sugin, *Politics, Disclosure, and State Law Solutions for 501(c)(4) Organizations*, 91 CHI.-KENT L. REV. 895 (2016).

9. See Treas. Reg. § 1.501(c)(3)-1(d)(2) (2015).

10. See generally John G. Simon et al., *The Federal Tax Treatment of Charitable Organizations*, in THE NONPROFIT SECTOR: A RESEARCH HANDBOOK, *supra* note 8, at 267-306; Brody, *supra* note 8, at 243-66.

11. This requirement currently appears at I.R.C. § 6033(a)(1) (2012).

12. See Evelyn Brody, *Business Activities of Nonprofit Organizations: Legal Boundary Problems*, in NONPROFITS & BUSINESS 83, 96-100 (Joseph J. Cordes & C. Eugene Steuerle eds., 2009) (discussing the operation of the Mueller Macaroni Company as a tax-free mechanism to support New York University Law School); see generally I.R.C. §§ 511-514 (2012).

13. See I.R.C. § 6104 (2012); see generally Evelyn Brody, *Sunshine and Shadows on Charity Governance: Public Disclosure as a Regulatory Tool*, 12 FLA. TAX REV. 183 (2012).

14. See litigation involving Prince Edward School Foundation, the Little Rock Private School Corporation, and other examples of "Massive Resistance" to desegregation.

enforcement actions involving racial discrimination arrived after an extraordinary legal process culminating in the Court's decision in *Bob Jones University v. United States*.¹⁵ That turbulent era also drew the IRS into anti-Vietnam War tax protests; tax exemption for feminist and gay rights groups, abortion rights advocates, and mail-order ministries; and later, in the Reagan administration, the Iran/Contra Affair.¹⁶ Incoming IRS Commissioners know to be wary of exempt-organization landmines—a sector that does not, by definition, have revenue effects.¹⁷ The controversy engendered by the *Citizens United* decision, discussed next, is only the latest in a long line of matters that cements the link between tax-exempt organizations and many of the seminal events in American society.

*B. Political Activity by Exempt Organizations and the “Tea Party Scandal”*¹⁸

While many nonprofits engage in advocacy activities as part of their charitable, educational, or religious purposes, the U.S. tax code (without using the term “advocacy”) denies Code § 501(c)(3) status to an organization engaged in more than insubstantial lobbying or in any political campaign activity. Treasury Department Regulations explain:

15. *Bob Jones Univ. v. United States*, 461 U.S. 574, 595 (1983) (holding, as a matter of statutory interpretation rather than constitutional law, that Congress did not intend the definition of charity in I.R.C. § 501(c)(3) to include educational organizations engaged in racial discrimination); see also David Brennan, *The Power of the Treasury: Racial Discrimination, Public Policy and “Charity” in Contemporary Society*, 33 U.C. DAVIS L. REV. 389, 400 (2000); see generally Evelyn Brody, *Entrance, Voice & Exit: The Constitutional Bounds of the Right of Association*, 35 U.C. DAVIS L. REV. 821 (2002).

16. For notable cases involving these issues, see *Branch Ministries v. Rossotti*, 211 F.3d 137 (D.C. Cir. 2000) (participation in politics over abortion issues); *U.S. Catholic Conference v. Abortion Rights Mobilization, Inc.*, 487 U.S. 74 (1988); *Universal Life Church, Inc. v. Comm’r of Internal Revenue*, 83 T.C. 292 (1984); *Big Mama Rag, Inc. v. United States*, 631 F.2d 1030 (D.C. Cir. 1980) (feminist publication); *Basic Bible Church v. Comm’r of Internal Revenue*, 74 T.C. 846 (1980) (mail-order ministries); *Rev. Rul. 78-305*, 1978-2 C.B. 172 (education about homosexuality); *Rev. Rul. 75-384*, 1975-2 C.B. 204; LAWRENCE WALSH, 1 FINAL REPORT OF THE INDEPENDENT COUNSEL FOR IRAN/CONTRA MATTERS (1993), <https://fas.org/irp/offdocs/walsh/>.

17. Interview with Lawrence B. Gibbs, Miller & Chevalier, Former IRS Comm’r (June 30, 2014) (quoting former Commissioner Gibbs: “I have been saying for the last 10-15 years to commissioners that came in, ‘Watch out for the tax-exempt organizations area,’ and the new commissioners usually look at me and say, ‘You mean charities?’ My reaction is, Well, that’s part of it’”); see a video of the interview at Tax Analysts, *The State of the IRS: A Conversation with Lawrence Gibbs*, YOUTUBE (June 18, 2014), https://www.youtube.com/watch?v=axY9r_FUGIE.

18. This Part I.B. draws substantially from Evelyn Brody, *Simultaneous Contrasts in the U.S. Law and Regulation of Charities*, 17 CHARITY L. & PRAC. REV. 113, 126–34 (2014) (UK); see also Donald B. Tobin, *The 2013 IRS Crisis: Where Do We Go From Here?*, 142 TAX NOTES 1120 (2014) and Philip Hackney, *Should the IRS Never “Target” Taxpayers? An Examination of the IRS Tea Party Affair*, 49 VAL. U. L. REV. 453, 478–80, 500–03 (2015), for more detailed background and analysis.

“The fact that an organization, in carrying out its primary purpose, advocates social or civic changes or presents opinion on controversial issues with the intention of molding public opinion or creating public sentiment to an acceptance of its views does not preclude such organization from qualifying under section 501(c)(3) so long as it is not an ‘action’ organization”¹⁹

By contrast, exemption under Code § 501(c)(4) requires only that the entity operate primarily to further the common good and general welfare of the community, and not of a private group of citizens.²⁰ Because furthering the common welfare includes advocating changes in the law, a social welfare organization exempt under § 501(c)(4) is not subject to § 501(c)(3)’s lobbying limitations. However, the Treasury Regulations provide: “The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office.”²¹ However, the IRS has ruled that as long as a § 501(c)(4) organization is “primarily” engaged in activities that further its social welfare purposes, its exempt status will not be adversely affected by “its lawful participation or intervention in political campaigns on behalf of or in opposition to candidates for public office” (although such political expenditures may be subject to tax under Code § 527).²²

Exemption under Code § 501(c)(4) is less desirable than under (c)(3) because contributions to (c)(4)’s do not entitle donors to claim charitable contribution deductions.²³ The legislature generally enjoys broad latitude in designing tax regimes, and the “doctrine of unconstitutional conditions” applies narrowly in the tax-exemption context. In 1983, the Supreme Court upheld Congress’s authority to prohibit a charity, as a condition of § 501(c)(3) exemption, from engaging in more than insubstantial lobbying.²⁴ In so deciding, however, the Court relied in part on the right of the (c)(3) organization to create a sister

19. Treas. Reg. § 1.501(c)(3)-1(d)(2) (2015) (providing that an “action organization”—one that engages in substantial lobbying or in any political campaign activity, or whose purposes can be achieved only by a change in the law; see also Treas. Reg. § 1.501(c)(3)-1(c)(3)—may instead qualify as a social welfare organization exempt under Code § 501(c)(4)).

20. See Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (2015).

21. Treas. Reg. §§ 1.501(c)(4)-1(a)(2)(ii) (2015).

22. Rev. Rul. 81-95, 1981-1 C.B. 332 (indicating that such activity still must run the gauntlet of applicable federal and state election law, even if permissible under federal tax law).

23. See I.R.C. § 170(c)(2) (2015). Moreover, to prevent tax-deducted gifts from being used for impermissible lobbying or politics, a (c)(3) organization that loses exemption for these activities is not eligible for (c)(4) status.

24. *Regan v. Taxation with Representation*, 461 U.S. 540, 551 (1983).

(c)(4) to exercise the group's right to speak to legislators.²⁵ As a result, the charity's advocacy (and permitted level of lobbying) could be supported by tax-deductible charitable contributions, but the affiliated (c)(4)'s lobbying and permitted level of political activity would be funded by after-tax dollars. Similarly, a (c)(4) whose primary activity would be political could instead establish a separate political action committee exempt under § 527. Critically, although political contributions are not tax-deductible either, § 527(j) requires public disclosure of the identities of every donor of more than \$200.

Recently a non-tax case upended this longstanding tax framework for political speech. In 2010, the Supreme Court struck down a federal election statute that prohibited corporations—for-profit as well as nonprofit—from engaging in unlimited independent expenditures on behalf of or in opposition to candidates for public office. *Citizens United v. Federal Election Commission*²⁶ focused on the First Amendment constitutional right to free speech, and did not address the requirements for federal tax-exempt status.

Citizens United the organization, though, is exempt from federal income tax under § 501(c)(4). While it is difficult to tease out the amount spent by Citizens United to produce and market the contested speech (*Hillary [Clinton]: The Movie*), the effort may well have been the only significant activity of the organization for a period of years. Since such a scenario would have caused Citizens United to fail the primary-purpose requirement of the § 501(c)(4) regulation, the Court (likely unbeknownst to itself) was a whisker away from invalidating the position in that regulation providing that political activity does not qualify as appropriate social welfare activity under § 501(c)(4).

While scholars generally assume that Congress could continue to prohibit (c)(3)'s from engaging in politics after *Citizens United*, political strategists found an opportunity to exploit the (c)(4) regulations, which were written for an era that did not contemplate unconstrained corporate political activity. Significantly, unlike § 527 political organizations, § 501(c)-exempt organizations can hide their donors from the public.²⁷ The Center for Responsive Politics found that anonymously

25. See *id.* at 552–54 (Blackmun, J., concurring).

26. *Citizens United v. Fed. Election Comm'n*, 558 U.S. 310 (2010).

27. The Form 990 currently requires the exempt organization to disclose to the IRS on Schedule B the identity of any donor of at least \$5,000, but this list (except for private foundation and § 527 organizations) is redacted from public disclosure. I.R.C. § 6104(b) (2012). The instructions for Schedule B, however, permit the filing organization to report as “anonymous” any donor whose identity is unknown to the organization. The same instructions also make it clear that a

funded independent expenditures in the 2012 presidential election cycle exceeded \$300 million;²⁸ the 2016 cycle promises over a billion dollars of “dark money.”²⁹

To the ultimate chagrin of the IRS, this repurposed use of (c)(4) status prompted applications for federal tax exemption from thousands of new organizations—most conservative; many small, unsophisticated, and acting without legal counsel; and some named “Tea Party.”³⁰ Sensibly, the understaffed IRS responded to this flood of novel

donor may hide its identity by channeling its contribution through an intermediary entity (such as a partnership or limited liability company), with the filing organization being required to report only the identity of the actual contributor (if known). Unfortunately, the IRS has hinted that it might eliminate the Schedule B entirely, so not even the IRS will routinely receive information on large donations. See Paul Streckfus, Editor, *EO Tax Journal*, Email Update 2016-62 (Mar. 29, 2016) (reporting the following exchange at the March 18, 2016 Washington Nonprofit Legal & Tax Conference: “Attendee: Last Fall Tamera Ripperda suggested that the Service might be considering deleting Schedule B from the Form 990. Is that still under consideration? ¶ [Sunita] Lough[, TEGE Commissioner]: Yes, we are working with Treasury and Counsel in considering it.”). On April 28, the House Ways and Means Committee, by party-line vote, reported out H.R. 5053, the Preventing IRS Abuse and Protecting Free Speech Act, which would bar the IRS from collecting the identity of large donors other than officers, directors and highly-compensated employees. See Naomi Jagoda, *House Panel Moves Bill to Ban IRS from Tracking Donors to Tax-Exempt Groups*, THE HILL (Apr. 28, 2016), <http://thehill.com/policy/finance/278031-house-panel-passes-bills-to-protect-taxpayers-and-children>; Editorial, *Dark Money and an I.R.S. Blindfold*, N.Y. TIMES, Apr. 29, 2016, at A20. Bill sponsor Rep. Peter Roskam (R-IL) said in the Committee’s press release:

“This bill **prohibits the IRS from collecting donor information** on the schedule B form The Schedule B is not needed for taxpayer administration. In fact, the **IRS has indicated they were considering eliminating the requirement themselves**. Tax exempt groups should not be forced to expend precious resources on unnecessary documentation and tax administration rather than focusing on their charitable missions. The **IRS has not demonstrated the capacity to safeguard confidential information** in the past. There is no reason we should send them any more sensitive information than they need to do their job.”

Press Release, U.S. House Ways & Means Comm., *W&M Takes More Action to Improve IRS* (Apr. 28, 2016), <http://waysandmeans.house.gov/ways-and-means-continues-effort-to-improve-irs-passing-three-more-pieces-of-reform-legislation/>.

28. See *Outside Spending by Disclosure, Excluding Party Committees*, OPEN SECRETS, <http://www.opensecrets.org/outsidespending/disclosure.php> (last updated Feb. 6, 2016) (“[o]utside groups that didn’t make their donors’ names publicly available, together with groups that received a substantial portion of their contributions from such nondisclosing groups accounted for nearly 44 percent of outside spending in the 2010 election cycle. Though spending by these groups was lower as a percentage of overall outside spending in 2012, the total spent by nondisclosing groups more than doubled from \$127.1 million in the 2010 cycle to well over \$300 million in 2012.”).

29. See Nicholas Confessore, *‘16 Koch Brothers Budget of \$889 Million for 2016 is on Par with Both Parties’ Spending*, N.Y. TIMES (Jan. 26, 2015), <http://www.nytimes.com/2015/01/27/us/politics/kochs-plan-to-spend-900-million-on-2016-campaign.html> (stating that the Koch brothers alone have pledged to spend almost \$900 million but other funds mask their supporters).

30. Ironically, only (c)(3) status requires advance IRS recognition of exemption, while other types of exempt organizations can simply “self declare” and file the annual Form 990, albeit at the risk that any revocation of exemption could be retroactive. See *Democratic Leadership Council v. United States*, 542 F. Supp. 2d 63, 76 (D.D.C. 2008) (holding that revocation should be prospective

and often incomplete (c)(4) applications by focusing attention on the questionable ones. Inevitably, though, the IRS's scrutiny drew out the process, and the agency opened itself up to charges of political bias by inappropriately using "Be On the Lookout" (BOLO) lists that included, among other screens, organizations with certain terms in their names (including "Tea Party," "9/12," and "Patriot"—and, it later transpired, "Progressive," "Occupy," "Acorn," and "Israel.").³¹ Note that screening rarely translated into denial.³²

Making life difficult for vocal organizations skeptical of federal power in general and the incumbent President's party in particular proved an unwise strategy for the IRS. In 2012, several stymied applicants found a sympathetic ear in the Republican chair of the House Oversight and Government Reform Committee,³³ who asked the Treasury Inspector General for Tax Administration (TIGTA) to investigate whether conservative groups were being "targeted" for special scrutiny.

On May 10, 2013, the Director of the Exempt Organizations Division, Lois Lerner, announced at an American Bar Association Tax Section meeting an apology for improper handling of applications for exemption from "Tea Party" groups.³⁴ Lerner—and, it later transpired, her equally-doomed boss, Acting Commissioner Steven Miller—tried to get out in front of the imminent release of TIGTA's report.³⁵ Allowing speculation to fester over the weekend only made things worse. While

only under the limitations on retroactive revocations in Treas. Reg. § 7805(b)(1)(c) (2006) and Treas. Reg. § 601.201(n)(6)(i) (2015), because the exemption application contained sufficient disclosure to put the IRS on notice of the organization's relationship to the Democratic Party).

31. See Hackney, *supra* note 18. For redacted lists from 2010, see *Ways and Means Committee List*, WAYS & MEANS COMM. DEMOCRATS, <http://democrats.waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/November%202010%20BOLO%20IRS0000001349-IRS0000001364.pdf>.

32. For the leaked 2011 internal IRS schedule made available to USA Today, see *EOD Political Advocacy Cases - Screened by EO Technical (11/16/11)*, USA TODAY (Sept. 17, 2013), <http://s3.documentcloud.org/documents/789861/usa-today-irs-political-advocacy-case-list.pdf>.

33. See Press Release, H.R. Comm. on Oversight & Governance, Lois Lerner and the Oversight Committee Investigation of the IRS Targeting Scandal (Mar. 4, 2014), <http://oversight.house.gov/release/fact-sheet-lois-lerner-oversight-committee-investigation-irs-targeting-scandal/> ("The Committee's investigation began in February 2012, after concerns about disparate treatment and inappropriate scrutiny of applicants for tax exempt status by the IRS were brought to the Committee's attention. The underlying concerns were IRS efforts to deny Americans their right to free political speech because of their beliefs . . .").

34. Rick Hasen, *Transcript of Lois Lerner's Remarks at Tax Meeting Sparking IRS Controversy*, ELECTION L. BLOG (May 11, 2013, 7:37 AM), <https://electionlawblog.org/?p=50160>.

35. TREASURY INSPECTOR GEN. FOR TAX ADMIN., REF. NO. 2013-10-053, INAPPROPRIATE CRITERIA WERE USED TO IDENTIFY TAX-EXEMPT APPLICATIONS FOR REVIEW (2013), <https://www.treasury.gov/tigta/auditreports/2013reports/201310053fr.html> [hereinafter TIGTA REPORT].

TIGTA's May 14, 2013 report used the word "targeting" to describe the actions of the Exempt Organizations Division on the processing of (c)(4) applications from "Tea Party," "Tea Party Patriots," and "9/12" groups (and was silent on whether other types of organizations received similar handling), the report did not ascribe political bias to the IRS's behavior.

But the combination of Lerner's announcement and the TIGTA report triggered a quick and strong reaction from President Barack Obama,³⁶ who promptly called for a Department of Justice investigation,³⁷ and Congress, which reacted with demands for records and interviews of employees, followed by endless partisan hearings that continue to this day.³⁸ None of the half dozen reports from TIGTA and the Government Accountability Office showed any evidence of outside direction or political motives.³⁹

The rapid purge of the entire top management of the IRS and its exempt organization function—whether through "resignation," retirement, reassignment, or administrative leave—left the agency no choice but to bring in lateral appointments from areas outside the Tax Exempt and Government Entities function.⁴⁰ Acting Commissioner Daniel Werfel (who was replaced in early 2014 after the Senate confirmed John Koskinen⁴¹) quickly developed and released a series of action papers designed to address delays and other aspects of the processing of the pending (c)(4) applications—a group of approximately 80 organiza-

36. Michael D. Shear & Jonathan Weisman, *Obama Dismisses New Benghazi Furor but Condemns I.R.S.*, N.Y. TIMES (May 13, 2013), http://www.nytimes.com/2013/05/14/us/politics/obama-addresses-benghazi-and-irs-controversies.html?_r=0.

37. Jonathan Weisman, *I.R.S. Chief Out After Protest Over Scrutiny of Groups*, N.Y. TIMES (May 15, 2013), <http://www.nytimes.com/2013/05/16/us/irs-says-counsel-didnt-tell-treasury-of-tea-party-scrutiny.html>.

38. *Oversight Hearing - Internal Revenue Service: Hearing Before the Comm. on Appropriations Subcomm. on Fin. Servs. and Gen. Gov't*, 113th Cong. 1-10 (2013) (testimony of the Hon. J. Russell George, Treasury Inspector General for Tax Administration).

39. See S. REP. No. 114-119, pts. 1-4, at 57 (2015).

40. By the end of summer 2013, Steven Miller, the Deputy Commissioner, Services and Enforcement, and Acting IRS Commissioner, Joseph Grant, the Commissioner, Tax Exempt and Government Entities, Lois Lerner, the Director of the Exempt Organizations Division, and Holly Paz, the Director of the Rulings & Agreements Office in the Exempt Organizations Division, were gone. Heather Maloy was named Deputy Commissioner, Michael Julianelle was named Commissioner, Tax Exempt and Government Entities, Kenneth Corbin was named Acting Director of the Exempt Organizations Division, and Karen Schiller was named Acting Director of Rulings and Agreements.

41. See Meg Shreve, *Senate Confirms Koskinen as IRS Commissioner*, 141 TAX NOTES 1245 (2013).

tions.⁴² New management cleared out the backlog of applicants by expediting (c)(4) status for applicants willing to certify that they would spend no more than 40 percent of their expenditures and time on political activities.⁴³ Members of Congress requested a similar review of the examination process, including the identification of tax-exempt organizations for audit; however, a hearing on this topic did not take place until August 2015.⁴⁴

At the “political” level, the irony-free critics of the IRS simultaneously believed that these organizations did not violate 501(c)(4)’s requirements and that dilatory actions by Democratic partisans in the agency (perhaps on orders from the White House) cost Mitt Romney the presidency in 2012. In the trenches, though, the spooked staff of the IRS—a tax-collection agency, not a political-regulatory body—continued to lack clear, updated guidance to carry out its thankless job, reflecting the robust growth of the seeds planted in 2003 when the IRS both cut training funds and delegated greater responsibility to its field staff.⁴⁵ While some argue that new regulations (if not a legislative fix, perhaps shifting more responsibility to the Federal Election Commission, an agency even more paralyzed than the IRS) are needed for a post-*Citizens United* world,⁴⁶ the absence of enforcement resources and bureaucrats willing to use them in the face of partisan political pressure will ensure that the current morass continues.

In November 2013, the Treasury Department and IRS attempted to redefine what constitutes political (as distinct from “social welfare”) activities by § 501(c)(4) organizations. The proposed regulations would have replaced the reference to “direct or indirect participation or intervention in political campaigns on behalf of or in opposition to

42. Press Release, Internal Revenue Serv., Report Outlines Changes for IRS to Ensure Accountability, Chart a Path Forward; Immediate Actions, Next Steps Outlined, IR 2013-62 (June 24, 2013), <http://www.irs.gov/uac/Newsroom/Report-Outlines-Changes-for-IRS-To-Ensure-Accountability,-Chart-a-Path-Forward;-Immediate-Actions,-Next-Steps-Outlined>.

43. The expedited process also ignores the limitation on private benefit in section 501(c)(4), making the seemingly naive assumption that the other 60% of the resources of an organization like Crossroads GPS are devoted to non-partisan activities that do not support the partisan message delivered by the 40% devoted to political activity. See *Optional Expedited Processing Offered to Certain 501(c)(4) Applicants Before December 23, 2013*, INTERNAL REVENUE SERV., <http://www.irs.gov/Charities-&-Non-Profits/New-Review-Process-and-Expedited-Self-Certification-Option> (last updated June 16, 2015).

44. See U.S. GOV’T ACCOUNTABILITY OFF., GAO-15-514, IRS EXAMINATION SELECTION: INTERNAL CONTROLS FOR EXEMPT ORGANIZATION SELECTION SHOULD BE STRENGTHENED 37 (2015), <http://waysandmeans.house.gov/wp-content/uploads/2015/07/7-23-15-GAO-Report.pdf>.

45. See description of the 2003 cuts *supra* note 5.

46. See, e.g., *About Us*, BRIGHT LINES PROJECT, <http://www.brightlinesproject.org/about-us/> (last visited Mar. 26, 2016).

any candidate for public office” with the new term “candidate-related political activity.” This new, broad concept embraced advocating for a clearly identified political candidate and contributions to a candidate or organization engaging in candidate-related political activity. Moreover, the proposal—to the surprise and distress of many, including some organizations on the left—also extended to several activities generally permitted even to § 501(c)(3) charities, in some cases by the Internal Revenue Code itself (as in the case of § 4945(f) and non-partisan voter registration).⁴⁷

At the same time, the proposed regulations did not address many important issues, on which the agency requested comments: What proportion of non-social-welfare activities is too much for (c)(4) status? What other specific activities, if any, should be included in the definition of candidate-related political activity? Should the same or similar rules be applied to § 501(c)(3) charities, § 501(c)(5) labor unions, and § 501(c)(6) trade associations, as well as to § 527 political organizations? By the February 2014 end of the comment period, the IRS had received over 160,000 comments, more public input than on any other proposed regulation in the agency’s history.⁴⁸ On May 22, 2014, the embattled agency withdrew the proposed regulations, announcing its determination to try again after taking the public’s comments into account.⁴⁹

A hardened sense of grievance, impervious to facts of even-handed “targeting”—and a conflation of constitutional protection of speech with entitlement to tax-exemption—continues to permeate the conservative press.⁵⁰ The week before the April 15, 2014 tax-filing deadline, two party-line votes by the Republican-dominated House committees asserted criminal behavior by former EO Division director

47. Prop. Treas. Reg. § 1.501(c)(4)-1(a)(2)(iii)(A), 78 Fed. Reg. 230 (Nov. 29, 2013) (engaging in a voter registration drive or “get-out-the-vote” drive; preparing or distributing a voter guide that refers to one or more clearly identified candidates; and hosting or conducting a candidates forum).

48. Fred Stokeld et al., *IRS Hearing on EO Guidance Expected in Spring*, 142 TAX NOTES 1078 (2014) (quoting the IRS deputy commissioner for services and enforcement). Most comments were very brief, and many—pro and con—nearly identical.

49. *IRS Update on the Proposed New Regulation on 501(c)(4) Organization*, INTERNAL REVENUE SERV. (May 22, 2014), [http://www.irs.gov/uac/Newsroom/IRS-Update-on-the-Proposed-New-Regulation-on-501\(c\)\(4\)-Organizations](http://www.irs.gov/uac/Newsroom/IRS-Update-on-the-Proposed-New-Regulation-on-501(c)(4)-Organizations).

50. Paul Caron’s TaxProf blog links to such headlines as “The IRS’s Torrent of Abuses” (*Town Hall*) and “IRS ‘Wants to Throw Us in Jail,’ Says Tea Party Leader” (*Washington Times*), as well as the *Tampa Bay Times*’ “PunditFact” analysis “Is the IRS Obama’s Watergate?” (concluding no). See Paul Caron, *The IRS Scandal, Day 345*, TAXPROF BLOG (Apr. 19, 2014), http://taxprof.typepad.com/taxprof_blog/2014/04/the-irs-scandal-16.html.

Lois Lerner. First, the Ways and Means Committee asked the Justice Department to pursue criminal charges for, among other things, her handling of the (c)(4) exemption application of Karl Rove's Crossroads GPS.⁵¹ The next day, the Government Oversight and Reform Committee held Lerner in criminal contempt of Congress despite her asserting her Fifth Amendment right not to answer the committee's questions;⁵² the full House's approval followed three weeks later.⁵³

In July 2014, after reports that hard drive crashes at the IRS made irretrievable swathes of emails stored on the computers of Lois Lerner and others breathed new life into congressional investigations, IRS Commissioner John Koskinen testified before Congress: "To date we have produced more than 960,000 pages of un-redacted documents to the tax-writing committees . . . and more than 700,000 pages of redacted documents to the House Oversight and Government Reform Committee and the Senate Permanent Subcommittee on Investigations." He added: "More than 250 IRS employees have spent more than 125,000 hours working directly on complying with the investigations, at a cost of approximately \$10.75 million."⁵⁴

No purpose would be served by reviewing the continuing partisan skirmishes over those lost (destroyed!) agency emails and suits by organizations granted their exemption over the lengthy process. What

51. Editorial, *Karl Rove Bamboozles the I.R.S.*, N.Y. TIMES (Feb 12, 2016), <http://www.nytimes.com/2016/02/12/opinion/karl-rove-bamboozles-the-irs.html>; Press Release, H.R. Comm. on Ways and Means, Ways and Means Committee Refers Lois Lerner to Department of Justice for Criminal Prosecution (Apr. 9, 2014), <http://waysandmeans.house.gov/news/documentsingle.aspx?DocumentID=375999>. The Democrats on the Committee complained that this charge could have been conveyed to Justice without publicly disclosing taxpayer information (applicants' identities are confidential until exemption is granted, if ever). See Press Release, H.R. Comm. on Ways and Means Democrats, Statement from W&M Democrats Opposing Referral Letter to Justice Department (Apr. 9, 2014), <http://democrats.waysandmeans.house.gov/press-release/statement-wm-democrats-opposing-referral-letter-justice>; see also George K. Yin, *Preventing Congressional Violations of Taxpayer Privacy*, 69 TAX LAWYER 103, 108 (2015).

52. See Press Release, H.R. Comm. on Oversight and Gov't Reform, Oversight Committee Approves Lois Lerner Contempt of Congress Resolution (Apr. 10, 2014), <http://oversight.house.gov/release/oversight-committee-approves-lois-lerner-contempt-congress-resolution/>. For the minority's objections, see Press Release, H.R. Comm. on Oversight and Gov't Reform Democrats, Rapid Response: Issa Blocks Cummings Request to Release IRS Interview Transcripts (Apr. 10, 2014), <http://democrats.oversight.house.gov/press-releases/rapid-response-issa-blocks-cummings-request-to-release-irs-interview-transcripts/>.

53. See *Recommending that the House Find Lois G. Lerner in Contempt of Congress*, CONGRESS.GOV (May 7, 2014), <https://www.congress.gov/congressional-record/2014/5/7/house-section/article/h3482-2>. The vote was 231-187, with six Democrats joining all the Republicans.

54. *Hearing Before the H. Oversight and Gov't Reform Comm., Subcommittee on Economic Growth, Job Creation and Regulatory Affairs*, 113th Cong. 4 (2014) (written testimony of John A. Koskinen, Comm'r, Internal Revenue Service), <http://oversight.house.gov/wp-content/uploads/2014/07/Koskinen-IRS-Final.pdf>.

should be the last word came on August 5, 2015, with the long-awaited results of the rarest of creatures: a bipartisan congressional investigation.⁵⁵ But even the Senate Finance Committee's 400-page report contains three parts: the facts as found by committee staff from both the majority and the minority, and separate conclusions and recommendations from the Republicans and the Democrats.⁵⁶ The joint press release provides spin from the two Committee leaders who reached the same conclusion that "this shouldn't happen again":

"This bipartisan investigation shows gross mismanagement at the highest levels of the IRS and confirms an unacceptable truth: that the IRS is prone to abuse," [Chairman Orrin] Hatch said. "The Committee found evidence that the administration's political agenda guided the IRS's actions with respect to their treatment of conservative groups. Personal politics of IRS employees, such as Lois Lerner, also impacted how the IRS conducted its business. American taxpayers should expect more from the IRS and deserve an IRS that lives up to its mission statement of administering the tax laws fairly and impartially – regardless of political affiliation. Moving forward, it is my hope we can use this bipartisan report as a foundation to work towards substantial reforms at the agency so that this never happens again."

"The results of this in-depth, bipartisan investigation showcase pure bureaucratic mismanagement without any evidence of political interference," said [Ranking Member Ron] Wyden. "Groups on both sides of the political spectrum were treated equally in their efforts to secure tax-exempt status. Now is the time to pursue bipartisan staff recommendations to ensure this doesn't happen again."

The IRS responded with a statement emphasizing its cooperation.⁵⁷

55. Partisanship has been institutionalized in Congress. On the House Ways and Means website, try to find the link to the page of the "minority" (it's in the lower left corner). The same is true for the House Oversight and Government Accountability Committee website. The Senate Finance Committee is the cooperative exception, but even its homepage has separate sections for the separate press releases of the Chairman and of the Ranking Member.

56. Go to the Finance Committee website's press section for the joint press release, with links to the bipartisan portion of the report, additional views from Chairman Hatch, and additional views from Ranking Member Wyden (plus a fourth link to a timeline). Press Release, Senate Comm. on Fin., Finance Committee Releases Bipartisan IRS Report (Aug. 5, 2015), <http://www.finance.senate.gov/newsroom/chairman/release/?id=11f4db1f-9986-4ecb-ba61-f3a8abeb2672>.

57. Press Release, Internal Revenue Serv., IRS Statement on the Senate Finance Committee Report (Aug. 5, 2015), <http://www.irs.gov/uac/Newsroom/IRS-Statement-on-the-Senate-Finance-Committee-Report>:

The IRS is fully committed to making further improvements, and we want to do everything we can to help taxpayers have confidence in the fairness and integrity of the tax system. We have already taken many steps to make improvements in our processes and procedures, and we are pleased to have other suggestions from the committee to help us in our continuing effort. The IRS is fully committed to making further improvements, and we want to do everything we can to help taxpayers have confidence in the fairness and integrity of the tax system. We have already taken many steps to

Nor did the partisan skirmishing stop on October 23, 2015, when the Justice Department closed its investigation into whether any IRS employee acted criminally, finding: "Our investigation uncovered substantial evidence of mismanagement, poor judgment and institutional inertia, leading to the belief by many tax-exempt applicants that the IRS targeted them based on their political viewpoints. But poor management is not a crime. We found no evidence that any IRS official acted on political, discriminatory, corrupt, or other inappropriate motives that would support a criminal prosecution."⁵⁸ Four days later, 23 House Republicans signed onto a proposal to impeach current Commissioner John Koskinen.⁵⁹ The budget deal reached in December 2015 prohibits the IRS from spending funds in the fiscal year ending September 30, 2016 on "a proposed regulation related to political activities and the tax-exempt status of 501(c)(4) organizations."⁶⁰

make improvements in our processes and procedures, and we are pleased to have other suggestions from the committee to help us in our continuing effort.

Throughout this, the IRS has cooperated with Congress and other investigators. The agency has produced more than 1.3 million pages of documents in support of the investigations, provided 52 current and former employees for interviews and participated in more than 30 Congressional hearings on these issues.

58. Letter from Peter J. Kadzik, Assistant Att'y Gen. for Legislative Affairs, to Rep. Bob Goodlatte Chairman, H. Comm. on Oversight and Gov't Reform, and Rep. John Conyers Jr., Ranking Member, H. Comm. on Oversight and Gov't Reform (Oct. 23, 2015),

<http://democrats.oversight.house.gov/sites/democrats.oversight.house.gov/files/documents/2015-10-23%20DOJ%20to%20HOCR%20%28IRS%29%20-%20Chmn%20Chaffetz%20RM%20Cummings.pdf>. Specifically, the letter found:

Throughout the investigation, not a single IRS employee reported any allegation, concern, or suspicion that the handling of tax-exempt applications . . . was motivated by political bias, discriminatory intent, or corruption. Among these witnesses were several IRS employees who were critical of Ms. Lerner's and other officials' leadership, as well as others who volunteered to us that they are politically conservative. Moreover, both TIGTA and the IRS's Whistleblower Office confirmed that neither has received internal complaints from IRS employees alleging that officials' handling of tax-exempt applications was motivated by political or other discriminatory bias.

Id.

59. H.R. Res. 494, 114th Cong. (2015), <http://thomas.loc.gov/cgi-bin/bdquery/D?d114:22:./temp/~bd8VZZ>.

60. See FY 2016 OMNIBUS, *supra* note 5.

II. THE IRS AND EO FUNCTION: UNDER NEW MANAGEMENT⁶¹

A. *The Winds, Breezes, and Slight Air Puffs of Change*

Starting in the fall of 2014, the IRS began releasing a number of tax administration policy statements, including the overall Strategic Plan FY 2014-2017 and the TE/GE Program Letters for FY 2015 and FY 2016.

The agency-wide Strategic Plan is a 40-page document that sets out, in eye-glazing management-speak, high-level “Goals” with enumerated “Objectives” and “Long Term Measures.” The goal to “[d]eliver high quality and timely service to reduce taxpayer burden and encourage voluntary compliance” is explained with phrases such as “seamless, multichannel service environment to encourage taxpayers to meet their tax obligations” and the “use of a holistic view of taxpayer interactions to provide a coordinated, consistent experience across all channels.”⁶² Presumably, further details will be forthcoming. The goal to “[e]ffectively enforce the law to ensure compliance with tax responsibilities and combat fraud”⁶³ includes an objective to “build and maintain public trust by anticipating and addressing the tax-exempt sector’s need for a clear understanding of its tax-law responsibilities.”⁶⁴ The three paragraphs of this objective are the Strategic Plan’s only references to tax-exempt organizations. Notably, the paragraphs do not reference enforcement or oversight, but rather speak in terms of taxpayer education, ensuring transparency, expediting and improving issue resolution, and addressing efficiency and productivity in the determination process. Nevertheless, the Long Term Measures do attempt to quantify enforcement through development of an index of enforcement activities that “promote compliance yet do not focus primarily on increasing tax revenue.”⁶⁵

61. The material in Part II is an updated version of Marcus S. Owens, *Dealing with Mass Confusion: Navigating The New EO*, Presentation at the Annual Washington Non-Profit Legal & Tax Conference (Mar. 20, 2015) (transcript available at Paul Streckfus’s EO Journal, Email Update 2015-62 (Tuesday, Mar. 31, 2015)).

62. INTERNAL REVENUE SERV., STRATEGIC PLAN, FY2014-2017 25 (2014), <https://www.irs.gov/pub/irs-pdf/p3744.pdf>.

63. *Id.* at 30.

64. *Id.* at 32.

65. The process is intended to assess changes in a manner similar to the way the Consumer Price Index reflects changes in consumer prices, using an index weighted two-thirds for TE/GE matters and one-third for bank secrecy matters. The goal is to exceed the 2003-2005 average by 10 percent. *Id.*

The Tax Exempt/Government Entities Commissioner's TE/GE Program Letter for FY 2015 set forth the function's key areas of focus for meeting the Strategic Plan's goals and objectives.⁶⁶ In essence, the Program Letter provided a statement of management/administrative philosophy rather than a directive to undertake specific program activities or address particular tax compliance issues.⁶⁷ TE/GE did not issue any more specific compliance documents identifying areas of enforcement during the remainder of fiscal year 2015. A year later, the TE/GE issued the next Program Letter as the "TE/GE Priorities for FY 2016."⁶⁸ This document, too, outlined the TE/GE's philosophy of tax administration, rather than signaled any particular issues of concern or enforcement focus. It did note that only 100 employees will be assigned to process applications for tax-exempt status, with an additional 25 lower-graded employees, known as tax examiners, assigned to process the Form 1023-EZ applications.⁶⁹ That represents a reduction of approximately two-thirds in the number of personnel assigned to that task in 2012.⁷⁰

B. Management Changes: Personnel, Structure, and Function

Since Lois Lerner's fateful apology in May 2013, the Internal Revenue Service in general, and the Exempt Organizations Division in particular, underwent extraordinary change. Besides the operational impact of replacing an entire function's management⁷¹—perhaps a first in the history of the agency—the IRS also dramatically realigned TE/GE's historical organizational structure. In March 2014, the IRS announced it would shift TE/GE's technical (legal) staff to the IRS's Office of Chief Counsel and move the head of the EO Division from Washington, D.C., to the Cincinnati office, which processes most of the

66. Memorandum from the TE/GE Comm'r on TE/GE's Key Areas of Focus for FY 2015 (Nov. 5, 2014), https://www.irs.gov/pub/irs-tege/tege_fy15_program_letter.pdf.

67. TE/GE listed five focus areas: "Continuous Improvement," "Knowledge Management," "Employee Engagement and Development," "Data-Driven Decision-Making," and "Risk Management." *Id.*

68. The staffing data appears on page 8. See Memorandum from the TE/GE Commissioner on TE/GE Priorities for Fiscal Year 2016 (2015), https://www.irs.gov/pub/irs-tege/TEGE_Priorities_for_FY2016.pdf.

69. See discussion of Form 1023-EZ in Part III *infra*.

70. INTERNAL REVENUE SERV., IRS EXEMPT ORGANIZATIONS FY 2012 ANNUAL REPORT & FY 2013 WORKPLAN 2 (2013), http://irs.gov/pub/irs-tege/FY2012_EO_AnnualRpt_2013_Work_Plan.pdf.

71. *About Us, Charities & Other Non-Profits*, INTERNAL REVENUE SERV., <http://www.irs.gov/Charities-&-Non-Profits/About-IRS-Exempt-Organizations> (last updated Feb. 16, 2016).

applications for tax exemption received each year.⁷² Moving the EO Division director to Cincinnati appeared to reflect a determination to prioritize reducing the backlog of applications.⁷³ The transfer to Chief Counsel of TE/GE guidance functions (including issuance of revenue rulings, revenue procedures, technical advice memoranda, and some private letter rulings), while a major change, conforms to restructuring the agency made years ago for other functions.⁷⁴ However, the exile of the EO Division Director, even if it helps streamline the perennially lengthy approval process, could make coordination between the field and headquarters (including Chief Counsel) more difficult, and appears to assume that an organizational structure designed for tax collection can also effectively serve a regulatory function. Such an assumption is essentially the opposite of the recommendation of the Commission on Private Philanthropy and Public Needs, also known as the Filer Commission, in 1975.⁷⁵

Within the EO Division, the IRS is following a redesign of the processes used for tax administration by using “Lean Six Sigma” concepts, a management assessment protocol that focuses on eliminating waste.⁷⁶

In August 2013, the then-Acting EO Division Director created a new function within the Division to better identify potential issues arising from the Division’s operations and make recommendations for an appropriate response—notably training, guidance, and coordina-

72. See generally Charlie S. Clark, *IRS Reorganizes Division at the Center of Controversy*, GOV’T EXEC. (Mar. 21, 2014), <http://www.govexec.com/management/2014/03/irs-reorganizes-division-center-controversy/81058/?oref=river>; William R. Davis & Fred Stokeld, *IRS Announces Shake-Ups in TE/GE and Chief Counsel’s Office*, 142 TAX NOTES 1308 (2014). The IRS has not posted an official version of the statement, but it can be found electronically in LEXIS’s Fedtax Library (Tax Notes Today file) at 2014 TNT 55-15, *IRS Announces Realignment of Some Legal Resources in TE/GE*, March 20, 2014.

73. See TIGTA REPORT, *supra* note 35. Note that the IRS expects the newly available Form 1023-EZ to reduce long-form applications by as much as 70 percent. See Part III *infra*.

74. This most recent Chief Counsel restructuring, effective January 2015, was reflected in the annual revenue procedures issued on January 2, 2015.

75. See COMM’N ON PRIVATE PHILANTHROPY & PUB. NEEDS, *GIVING IN AMERICA: TOWARD A STRONGER VOLUNTARY SECTOR 190* (1975) [hereinafter “FILER COMM’N”] (“[T]he Internal Revenue Service . . . is the nation’s single most influential overseer of the philanthropic world, because of its power to determine, within broad limits of the law, what organizations are eligible for charitable status and therefore can receive tax-deductible gifts. Yet the IRS’s oversight is incidental to its revenue-collecting role.”).

76. Lean Six Sigma defines eight kinds of waste: defects, overproduction, waiting, non-utilized talent, transportation, inventory, motion and extra-processing. Honoring the Japanese origin of this management theory, implementing Lean Six Sigma concepts assigns employees different “belts” reflecting different skill levels, e.g., white, yellow, green, black and master black belts, similar to karate.

tion with other functions.⁷⁷ The Emerging Issue Committee is intended to represent a variety of functions, including EO Examinations, EO Rulings & Agreements, Chief Counsel TE/GE, the TE/GE Senior Technical Advisor, the EO Senior Technical Advisor, the TE/GE Fraud Specialist and the TE/GE Assistant Promoter Coordinator. The Committee will serve as the focal point to coordinate issues within EO, TE/GE, Chief Counsel TE/GE, other IRS divisions and other federal and state agencies. The Committee Charter provides that meetings will occur at least once a month, and that minutes will be kept of the meetings.

C. Determinations/Rulings Changes

Historically, the bulk of applications for tax-exemption have been for § 501(c)(3) status. For example, in fiscal year 2012, the IRS processed 60,793 applications, 51,748 of which sought § 501(c)(3) status. Of those, 45,029 were approved, 123 were denied tax-exempt status and 6,596 were withdrawn, returned as incomplete, failed to provide requested information, or resulted in the IRS's refusal to rule.⁷⁸ Following the May 2013 TIGTA report, the EO Division has been reviewing its processes for handling all types of applications for tax-exempt status.⁷⁹ The EO Division regularly reports the nature of the changes being implemented, and the general status of the implementation, on its homepage on the IRS website.⁸⁰

In February 2014, the EO Division published revisions to the procedures for processing exemption applications that were developed using Lean Six Sigma Organization concepts.⁸¹ The new streamlined process appears to call for minimal evaluation of applications, applying a triage on the filings that divides them into: (1) a group of applications considered complete and in compliance with organizational and opera-

77. The Committee was formed by expanding the size and role of the former EO ATAT (Abusive Tax Avoidance Transactions) Committee. Memorandum from Kenneth Corbin, Acting Dir., Exempt Orgs., TE/GE on the EO Emerging Issue Committee to all Exempt Organization Employees (Sept. 30, 2013).

78. INTERNAL REVENUE SERV., INTERNAL REVENUE SERVICE DATA BOOK, 2012 55 (2013) (Table 24: Closures of Applications for Tax-Exempt Status, by Organization Type and Internal Revenue Code Section, Fiscal Year 2012).

79. See Memorandum from Kenneth Corbin, Act. Director, Exempt Orgs., TE/GE on Interim Guidance on Initial Classification of Applications to all Employees - Exempt Organizations Determinations Unit (Sept. 30, 2013).

80. *IRS Charts a Path Forward with Immediate Actions*, INTERNAL REVENUE SERV., <http://www.irs.gov/uac/Newsroom/IRS-Charts-a-Path-Forward-with-Immediate-Actions> (last updated Jan. 22, 2016).

81. Memorandum from Stephen A. Martin, Acting Dir., Exempt Orgs., Rulings and Agreements on Streamlined Processing Guidelines for All Cases (Feb. 28, 2014).

tional requirements; (2) a group in which the information submitted indicates defects in the organizing documents, for example, in the purposes clause of articles of incorporation, or inadequate or ambiguous descriptions of planned operations, but where “there was no clear evidence of an issue that would cause the organization to be denied exemption”; and (3) a group where there are clear indications of noncompliance.

The IRS would approve applications in the first category without further consideration. Applicants in the second category would not be asked to correct and submit revised organizational documents or submit more detailed descriptions of activities, but simply be asked to attest in writing to having made appropriate changes to documents or that activities will be within the parameters of the applicable Code section. The IRS would give a more in-depth review and analysis to applications in the third category. Separately, responding to pointed criticism that it posed intrusive or irrelevant questions to § 501(c)(4) applicants, the IRS placed on its website a series of sample questions organized around particular topics.⁸²

The ongoing wave of congressional hearings, investigations, and demands for records, as described above, severely distracted the Exempt Organizations Division from its normal work. Resource allocation was exacerbated by overall government budget constraints and the 2014 sequester, which resulted in temporary furloughs of IRS employees.⁸³ While the backlog of applications had been building for some time, even with the new triage approach, the EO Division faced an unprecedented inventory of unprocessed applications for tax-exempt status, perhaps approaching 80,000.⁸⁴ Advisors were complaining that it took months for a Form 1023 (application for recognition of (c)(3) status) or Form 1024 (application for other exemption) even to be assigned to an EO reviewer.

82. Notably, on February 21, 2014, the IRS posted to its website sample questions that an applicant might receive on the subject of lobbying and political activities. *Attempting to Influence Legislation or Political Campaign Intervention Activities, Applying for Exemption/Misc. Determination: Sample Questions*, INTERNAL REVENUE SERV., <http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Exempt-Organization-Sample-Questions-Attempting-to-Influence-Legislation-or-Political-Campaign-Intervention-Activities> (last updated Nov. 24, 2015).

83. See FURLOUGH THREATS HAVE RETURNED IN 2015, FEDWEEK (2015), www.fedweek.com/assets/files/FEDweek_furlough_prospects_2015.pdf.

84. Laura Kalich & Rebekuh Eley, *The IRS Introduces New Leadership and Initiatives to Practitioners in Baltimore*, BLOG OF THE BDO NONPROFIT & EDUC. PRAC.: NONPROFIT STANDARD (Mar. 17, 2014), <http://nonprofitblog.bdo.com/index.php/2014/03/17/the-irs-introduces-new-leadership-and-initiatives-to-practitioners-in-baltimore/>.

A significant number of those applications, perhaps 30 percent, came from small organizations whose tax-exempt status had been automatically revoked for failure to file a series Form 990 for three consecutive years pursuant to Code § 6033(j). Congress enacted § 6033(j) as part of the Pension Protection Act of 2006, so its impact began to be felt by the nonprofit sector in 2009. While most of the auto-revoked organizations appear to have actually gone out of business, a substantial number, over 25,000, are still in existence, and the statute required them to file new applications for exemption.⁸⁵ As the IRS realized the enormous scale of the auto-revoked applications, it developed special streamlined procedures to help reduce the backlog.⁸⁶

D. Examination Changes

The IRS's focus since May 2013 has fallen primarily on the Herculean task of cleaning the stables—the processing of applications for tax-exempt status. Most employees in the EO Division, however, are engaged in the examination function; they are revenue agents who conduct audits of tax-exempt organizations. The Division's Annual Report for FY 2012, the most recent one available, shows 516 of the 900 employees in the Division assigned to the examination function, compared to 335 involved in the processing of applications, private letter ruling requests, and related operations.⁸⁷ Recent other documents, however, have suggested that the number of actual revenue agents available to conduct examinations—as distinguished from personnel involved in examination planning, management and other activities in support of examinations—fell to 155.⁸⁸ The TE/GE Program Letter for fiscal year 2015, as described above, did not address specific issues or enforcement plans as it has in the past, but rather described a general overall approach to tax administration.⁸⁹ The TE/GE Priorities for FY 2016⁹⁰ included “Workplan Briefings” for each functional area under

85. *Revoked? Reinstated? Learn More*, INTERNAL REVENUE SERV., <http://www.irs.gov/Charities-&-Non-Profits/Automatic-Revocation-of-Exemption> (last updated Feb. 16, 2016).

86. *Automatic Revocation – How to Have Your Tax-Exempt Status Retroactively Reinstated*, INTERNAL REVENUE SERV., <http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Automatic-Revocation-How-to-Have-Your-Tax-Exempt-Status-Retroactively-Reinstated> (last updated Feb. 11, 2016).

87. IRS EXEMPT ORGANIZATIONS FY 2012 ANNUAL REPORT & FY 2013 WORKPLAN, *supra* note 70, at 11.

88. Memorandum from Stephen A. Martin, *supra* note 81.

89. *See supra* notes 62–65 and accompanying text.

90. *See supra* notes 66–70 and accompanying text.

the Division Commissioner. These “Briefings” listed broad issues of concern, such as “Exemption: Issues include non-exempt purpose activity and private inurement, enforced primarily through field examination.”

The EO Division has not, to date, made any substantive public statements about the nature and focus of its examination program (apparently undergoing a Lean Six Sigma analysis), other than the “Briefings” just described. The Division was, however, more forthcoming to the Government Accountability Office with regard to its examination priorities. The GAO, in its December 2014 report entitled *Tax-Exempt Organizations: Better Compliance Indicators and Data, and More Collaboration with State Regulators Would Strengthen Oversight of Charitable Organizations*, noted that the EO Division plans to review returns for potential areas of noncompliance, “such as legislative or overseas activities, compensation issues, and unrelated business activity.”⁹¹

With respect to exams relating to exempt-organizations’ political activities, the IRS issued a new procedure, coinciding with a July 2015 Congressional hearing and in response to a Government Accountability Office audit,⁹² for constituting its Political Activities Referral Committees (PARCs). “Effective immediately,” the IRS memorandum declared, “a PARC will consist of three IR-04 managers (OPM General Schedule (GS) grade 14 equivalent) who will be selected at random [and receive training].” Specifically, “[a] PARC will review and recommend [by majority vote] referrals for audit in an impartial and unbiased manner. A PARC must identify and document to the case file that the referral and associated publicly available records establish that an organization and any relevant persons associated with that organization may not be in compliance with Federal tax law.”⁹³ Unfortunately, the process of random selection will likely produce panels with little experience adminis-

91. U.S. GOV’T ACCOUNTABILITY OFF., GAO-15-164, TAX EXEMPT ORGANIZATIONS: BETTER COMPLIANCE INDICATORS AND DATA, AND MORE COLLABORATION WITH STATE REGULATORS WOULD STRENGTHEN OVERSIGHT OF CHARITABLE ORGANIZATIONS 33 (2014), <http://www.gao.gov/assets/670/667595.pdf>.

92. See U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-15-514, IRS EXAMINATION SELECTION: INTERNAL CONTROLS FOR EXEMPT ORGANIZATION SELECTION SHOULD BE STRENGTHENED (2015), <http://waysandmeans.house.gov/wp-content/uploads/2015/07/7-23-15-GAO-Report.pdf>.

93. Memorandum from Tamera L. Ripperda, Dir. Exempt Orgs., on Political Activities Referral Committee to All Exempt Organization Managers (July 17, 2015), [http://www.irs.gov/pub/foia/ig/spder/TEGE-04-0715-0018%20EO%20Political%20Activities%20Referral%20Committee\[1\].pdf](http://www.irs.gov/pub/foia/ig/spder/TEGE-04-0715-0018%20EO%20Political%20Activities%20Referral%20Committee[1].pdf).

tering exempt organizations—replacing a concern over political bias with a bias toward inexperience.

*E. Opportunities for Exempt Organizations to
Game the Current Situation*

The IRS's administration of the Code provisions applicable to tax-exempt organizations remains in a period of transition. These new processes and procedures will require adjustment when unintended consequences emerge, particularly as the agency's new organizational structure begins to address enforcement responsibilities that formerly were housed under a single exempt-organizations director. In the meantime, exempt organizations can take advantage of the newly created discontinuity in oversight between the exemption-application process and the advance ruling process.

Applications for tax-exempt status are being processed very quickly: according to some practitioners, under two months even for the long-form Form 1023 filers, and activities that formerly would have been explored by the IRS with requests for additional information are now being handled without such development. As described in Part III, below, life is even easier for Form 1023-EZ filers, which have essentially a registration process. At the same time, private letter rulings on proposed transactions will now be handled by the Office of Chief Counsel, TE/GE.⁹⁴

The contrast is stark between the celerity of the application process, with less rigorous review than in the past, and the fact that private letter rulings on proposed transactions are now going to be processed by the Office of Chief Counsel, with, no doubt, significant evaluation, a higher user fee and a longer processing time. Accordingly, an existing tax-exempt organization planning to undertake substantial new activities may want to house those new activities in a new corporate entity that applies for § 501(c)(3) status on its own. As long as its Form 1023 provides a sufficiently detailed description of the new activities, the exemption application would provide adequate notice to the IRS to merit § 7805(b) relief from retroactive revocation in the event of a subsequent challenge. Such a process would effectively protect the existing exempt organization's status, while enabling the new activity to be initiated without the time, expense and close scrutiny that a private letter ruling would entail.

94. See FILER COMM'N, *supra* note 75.

III. TIME FOR A 501(C)(3)-EZ STATUS?⁹⁵

To its evident relief, the IRS has finally found a winning formula to reduce and manage the flood of exemption applications that pour in every year. In July 2014, it introduced a Form 1023-EZ, which allows very small charities to self-certify their exemption under § 501(c)(3). Many academics, advisors, and state regulators, however, criticized the agency for sacrificing its historic gate-keeping role over the exemption of new small charities. Observers also worry about making life too easy to start up a charity, which deserves a sound governance structure and well-thought-through plan for sustainability, particularly in the absence of a robust examination program.

A better approach might be to provide that exemption granted to a 1023-EZ filer expires after five years. Founders whose charitable projects were achieved (or, simply, saw their initial enthusiasm waning) would have an opportunity to exit gracefully; if the charity wants to continue exemption, the IRS could consider its new application in light of its operating history. Moreover, if the charity is now too large to file a Form 1023-EZ, it would be required to file the full Form 1023, with all the required attachments.

Since the Tax Reform Act of 1969, almost 50 years ago, the fundamental distinction for the subset of exempt organizations that are 501(c)(3) charities has been between private foundations and public charities. Recently, though, for exempt organizations other than private foundations and political organizations, Congress and the IRS have focused on size. The Pension Protection Act of 2006 enacted a tax filing for small exempt organizations (except churches), but permits non-private foundations with annual revenue of \$50,000 or less (and assets of \$250,000 or less) simply to notify the IRS of their continued existence; the (online only) Form 990-N requires no substantive information.⁹⁶ At the same time, the IRS significantly raised the revenue and asset caps for eligibility for the Form 990-EZ, so that only the very largest exempt organizations file a full Form 990.⁹⁷

The 2014 IRS Data Book dramatically demonstrates the attractiveness of the Form 1023-EZ (and the process simplifications, de-

95. Part III is an updated version of Evelyn Brody, *Time for an EO-EZ Status for Small Charities?*, 147 TAX NOTES 815 (2015).

96. All private foundations, regardless of size, must file Form 990-PF.

97. *Which Forms Do Exempt Organizations File?*, INTERNAL REVENUE SERV., <https://www.irs.gov/Charities-&-Non-Profits/Form-990-Series-Which-Forms-Do-Exempt-Organizations-File-Filing-Phase-In> (last updated Feb. 8, 2016).

scribed above, aimed at easing the reinstatement of small charities that automatically lost exemption for failure to file): Exemptions granted in the year ending September 30, 2014 more than doubled from the prior fiscal year.⁹⁸ Through December 2014, the IRS received over 20,000 Forms 1023-EZ, accounting for about 49 percent of (c)(3) applications, and now it takes less than 30 days to process them.⁹⁹ The IRS observed: “Using the streamlining concepts that formed the basis of the Form 1023-EZ, EO reduced the inventory of cases that were more than 270 days old by 91 percent – from 54,564 (in April 2014) to 4,791 (in September 2014).”¹⁰⁰

Thanks to the Form 1023-EZ, very small public charities can now self-declare their 501(c)(3) status; there is no process for independent confirmation of the eligibility of the organizations to utilize the 1023-EZ. Professor George Yin divides the universe of 1023-EZ-eligible applicants into three groups: (1) the “sincere and well advised”; (2) the “sincere but not well advised”; and (3) “insincere applicants.”¹⁰¹ For this last group, Yin comments, the IRS’s instructions remove any uncertainty over which boxes are most desirable to check. He adds: “Insincere applicants that are strategic might go even further, and develop techniques to minimize the chance their lack of sincerity will be discovered.”¹⁰²

The benign use of a simplified process has clear advantages for the IRS, which estimated that the final version of the application form could be used by as many as 70 percent of new (c)(3) applicants.¹⁰³ And the simplified process has obvious advantages to start-up public charities (at the risk, discussed below, that even Yin’s “sincere and well

98. See INTERNAL REVENUE SERV., INTERNAL REVENUE SERVICE DATA BOOK, 2014 57 (2015) (noting: “The total number of approved applications for tax-exempt status increased from 44,274 in Fiscal Year (FY) 2013 to 110,656 in FY 2014.”). The number of approved applications decreased somewhat in the most recent year. See INTERNAL REVENUE SERV., INTERNAL REVENUE SERVICE DATA BOOK, 2015 57 (2016) (reporting, in table 24, that of 101,962 applications received, the IRS approved 95,372), <https://www.irs.gov/pub/irs-soi/15databk.pdf>. Compare the 2012 data, set out in *supra* note 78.

99. *Progress Update on Form 1023-EZ*, INTERNAL REVENUE SERV., <http://www.irs.gov/portal/site/irspup/menuitem.143f806b5568dcd501db6ba54251a0a0/?vgnextoid=44beb23f06ffb410VgnVCM1000003b4d0a0aRCRD> (last updated Mar. 11, 2015).

100. *Id.*

101. George K. Yin, *The IRS’s Misuse of Scarce EO Compliance Resources*, 146 TAX NOTES 267, 268 (2015).

102. *Id.* at 269.

103. *New 1023-EZ Form Makes Applying for 501(c)(3) Tax-Exempt Status Easier; Most Charities Qualify*, INTERNAL REVENUE SERV. (July 1, 2014), <http://www.irs.gov/uac/Newsroom/New-1023-EZ-Form-Makes-Applying-for-501c3Tax-Exempt-Status-Easier-Most-Charities-Qualify> [hereinafter *New 1023-EZ Form*].

advised” organizations will likely take a pass on the educational benefits of consulting with counsel before filing for exemption). Despite worries over making it too easy to obtain exemption and the proliferation of new charities that languish after the initial burst of enthusiasm wanes, a small charity does not really merit fiscal concern *as long as it stays small*.

In order to minimize and standardize the application for small charities—defined as organizations anticipating \$50,000 or less in annual revenues—the Form 1023-EZ must be filed electronically.¹⁰⁴ The applicant simply checks the appropriate representations in the three-page Form 1023-EZ that it satisfies the identified requirements of section 501(c)(3). No attachments (i.e., articles of incorporation, bylaws, budget, or other documentation) can accompany this filing.¹⁰⁵ For the average potential donor the (c)(3) status is indistinguishable from that granted after a substantive review.¹⁰⁶

In response to heavy opposition to the proposed version of the Form 1023-EZ, the IRS did reduce the eligibility threshold: Applicants must have assets of \$250,000 or less (originally \$500,000 or less) and annual gross receipts of \$50,000 or less (originally \$200,000 or less).¹⁰⁷ What about, though, the acorn that grows into an oak? The IRS explains: “An applicant should complete the eligibility worksheet using a ‘good faith’ estimate of its projected financial data. If an applicant’s gross receipts exceed \$50,000 unexpectedly at some point in the future, there is no action needed by the applicant.”¹⁰⁸ Ironically, given the events that prompted the IRS to develop this process, an existing

104. *Id.*; see also *Form 1023-EZ*, INTERNAL REVENUE SERV., <http://www.irs.gov/pub/irs-pdf/f1023ez.pdf> (last updated June 2014); Rev. Proc. 2014–40, I.R.B. 2014–30.

105. See Paul C. Barton, *Shortened Charity Application Succeeding So Far*, 146 TAX NOTES 1216 (2015) (“Common errors that still slow the process include entering incorrect employer identification numbers and not responding to IRS inquiries in general, [Sunita] Lough [IRS Tax-Exempt and Government Entities Division commissioner,] said.”).

106. See *Will Grantors and Contributors be Able to Tell we Filed Form 1023-EZ?, New Form 1023-EZ – All Frequently Asked Questions*, 501(c)(3) BOOK, http://501c3book.org/EZ_Grantors_Contributors.html (last updated Jan. 2015) (explaining that “[s]uccessful public charity EZ-filers receive Form Letter 5436, which the Internal Revenue Manual [at 21.3.8.11.8, ¶ 15 (10-01-2014)] says is ‘equivalent to’ FL 947 sent to long-form applicants,” but no distinction is made in the IRS’s Select Check database); see also TAX EXEMPT & GOV’T ENTITIES’ COMM’CNS & LIAISON, HOW TO APPLY WEBINAR Q&AS: PART 2 OF 2 (2014), <http://www.irs.gov/PUP/charities/charitable/How%20to%20Apply%20QAs%20Part%202%20FINAL.pdf> [hereinafter WEBINAR Q&AS] (explaining that the Service does not “plan to indicate on the Business Master File whether an organization received its tax-exempt status pursuant to a Form 1023-EZ”).

107. *New 1023-EZ Form*, *supra* note 103.

108. WEBINAR Q&AS, *supra* note 106, at Q&A 1.

501(c)(4) organization, if eligible, can use the Form 1023-EZ to switch to (c)(3) status.¹⁰⁹

With respect to small organizations, this framework transforms the regime calling for the strictest up-front oversight (because of the availability of the § 170 deduction for contributions) into one even easier than that for non-(c)(3) “self-declarers” who come in from the cold by filing a Form 1024.¹¹⁰ The new approach risks creating another “IRS scandal” for the next management fixer to remedy, as noted by *EO Tax Journal* editor Paul Streckfus: “I suspect that the current EO leadership at the IRS knows having individuals self-certify or ‘attest’ their organizations’ qualification for exempt status will result eventually in thousands of organizations that have no business being treated as (c)(3)s to which contributions are deductible. But by that time the current leadership will have moved on or retired and the next generation can be brought in to fix the situation”¹¹¹

The full Form 1023 process produces, every week, a release of the IRS’s denial and revocation letters that attest to the value of the agency’s gate-keeper function.¹¹² Both the charitable sector¹¹³ and state charity regulators¹¹⁴ have raised concerns about whether the IRS can monitor “small” exempt organizations through examinations by its Review of Operations Unit.¹¹⁵

109. *Id.*

110. *See id.* (“We’re not currently in the process of developing a Form 1024-EZ.”); *Self-Declarers Questionnaire*, INTERNAL REVENUE SERV., <http://www.irs.gov/Charities-&-Non-Profits/Other-Non-Profits/Self-declarers-questionnaire-for-section-501-c-4-5-and-6-organizations> (last updated Apr. 23, 2014) (discussing “self-declarers”). Section 405 of the Protecting Americans from Tax Hikes Act of 2015, Pub. L. 114-40 (Dec. 18, 2015), created I.R.C. § 506, requiring a new organization to notify the IRS, within 60 days of creation, of its intent to claim (c)(4) status (the notification requirement also applies to existing organizations that have not previously applied for exemption or filed an annual return).

111. *See* Paul Streckfus, *EO TAX J.* 2015-25 (Feb. 6, 2015).

112. *See, e.g.*, I.R.S. Determination Ltr. 201430014 (Apr. 30, 2014), <http://www.irs.gov/pub/irs-wd/201430014.pdf> (denying exemption to an organization whose stated purpose is the “protection of the human rights of defenseless victims from involuntary microwave and M attack, organized stalking, or direct mind control attack of its various forms, and to compensate such targets from (SIC) the associated damage or death resulting from such sightings.”).

113. *See* Massimo Calabresi, *IRS to Rubber-Stamp Tax-Exempt Status for Most Charities After Scandal*, *TIME* (July 13, 2014), <http://time.com/2979612/irs-scandal-tax-exempt-tea-party-political-groups-john-koskinen/>.

114. Nat’l Assoc. of St. Charities Officials, Comment Letter on Proposed Internal Revenue Service Form 1023-EZ (Apr. 30, 2014), <http://www.nasconet.org/wp-content/uploads/2014/05/FINAL-NASCO-comments-re-Form-1023-EZ1.pdf>.

115. Brad Bedingfield, *Blame It on the ROO: Form 1023-EZ and Decline of EO Determinations*, *TAX ANALYSTS* (July 14, 2014),

Commissioner Koskinen has responded to these concerns with three points. First, he asserts, electronic filing of the Form 1023-EZ will allow the IRS to more easily screen questionable applications, although he has not indicated how the agency will be able to do so effectively in the absence of any real information on the form. Second, the agency will test a statistical sampling of the applications “and put them through the more rigorous process, to see if they’ve answered the questions correctly, or whether . . . if they’d gone through the 26-page questionnaire, [they] would have been not qualified, . . . and see how accurate is the short form.” Finally, the IRS will “take another statistical sample, once they’re out a year, and go out and audit how they’re doing and what are they doing.”¹¹⁶ The IRS has historically had difficulty with statistical sampling in the exempt organizations area because of the extraordinarily diverse nature of the universe of tax-exempt organizations inhibiting the ability to obtain statistically valid results.¹¹⁷

In its March 2015 Progress Update,¹¹⁸ the IRS reported that a sample from “six-month filing data shows that approximately 95 percent of the Form 1023-EZ applicants receive a favorable determination letter as compared to approximately 94 percent favorable determination letters issued for Form 1023 filers.” Pledging to “continue to monitor the filings and use of the Form 1023-EZ,” the EO Division “will implement a post-determination compliance program in early fiscal year 2016 by conducting correspondence examinations of a random sample of organizations that obtained exempt status through the filing of a Form 1023-EZ.” In addition, “EO expects to issue updated guidance for the streamlined processes in the near future.”

In late 2014, EO Division Director Tamera Ripperda described a data-driven strategy for exams, adding: “We’re actually adopting a risk-based approach to choosing which cases we will work.”¹¹⁹ She expressed hope that the process would be more efficient, more reliable, and less cumbersome.¹²⁰ A skeptical George Yin, however, asked:

<http://www.taxanalysts.com/www/features.nsf/Features/83896E3877EA2C0985257D150067C166?OpenDocument>.

116. William Hoffman, *Tax Analysts Exclusive: Conversations: John Koskinen*, TAX ANALYSTS (July 31, 2014).

<http://www.taxanalysts.com/www/features.nsf/Articles/6BE36D73F5F1AB3385257D26004D216E?OpenDocument>.

117. Chih-Chin Ho, *Form 990-T Compliance*, IRS RES. BULL. 1992, Pub. 1500 (12/92), at 47.

118. *See supra* note 99.

119. As reported in David van den Berg, *Development of Short Exemption Form Guides New Exam Plan*, 145 TAX NOTES 992 (2014).

120. *Id.*

“Exactly what is there for the IRS to screen and analyze when essentially the only information submitted—electronically, to be sure—is a series of completely opaque attestations?”¹²¹ Evoking the troublesome solution resorted to by EO in screening the Tea Party and other (c)(4) applications, Yin asked: “Could it be that the commissioner is envisioning a screening process based on the name of the applicant—one of the few pieces of information revealed on the short form?”¹²²

Yin also chided the IRS for squandering the free leverage it has long enjoyed from legal counsel consulted by applicants baffled by the lengthy Form 1023: “If anything, given that the IRS must reduce the resources it can devote to the task, one would have thought that the compliance obligations of applicants might have been ratcheted up a little bit. As it is, I predict that increasing numbers of applicants, even ones sincerely interested in complying with the law, will not seek professional assistance to complete what seems like such a simple form. If true, compliance with the law will likely fall.”¹²³

In her July 2015 report to Congress, the National Taxpayer Advocate reported that the IRS, at her request, tested a sample of 1023-EZ applications by obtaining additional information from the 411 organizations for which a determination had been made.¹²⁴ The IRS recognized the (c)(3) status of 301 of those, prompting her to comment: “This approval rate – 73 percent – is far lower than the 95 percent rate for Form 1023-EZ filers generally.”¹²⁵ She specifically found that 21 percent of the sampled 1023-EZ filers projected gross receipts in excess of \$50,000, and that 9 percent of filers had actual receipts above that threshold.¹²⁶ She observed: “Had additional questions not been asked of these organizations, EO would have granted them exempt status despite the demonstrably incorrect attestations and even though TE/GE has determined that as a rule, applications from organizations in that class should receive greater scrutiny.”¹²⁷

121. Yin, *supra* note 101, at 269.

122. *Id.*

123. *Id.* at 271.

124. NAT'L TAXPAYER ADVOCATE SERV., FISCAL YEAR 2016 OBJECTIVES REPORT TO CONGRESS, AREA OF FOCUS #8: THE IRS APPROVES MANY APPLICATIONS FOR TAX-EXEMPT STATUS ALMOST AUTOMATICALLY, OFTEN BASED ON INSUFFICIENT INFORMATION 72 (2015), http://www.taxpayeradvocate.irs.gov/Media/Default/Documents/2016-JRC/Area_of_Focus_8_Insufficient_Information_for_Tax_Exempt_Status.pdf.

125. *Id.* at 73 (footnote omitted).

126. *Id.* at 74.

127. *Id.*

The National Taxpayer Advocate's January 2016 annual report reiterated her complaint that the IRS plans on "auditing its way out of the noncompliance it helped create."¹²⁸ She stated: "The IRS's own analysis of a representative sample of Form 1023-EZ filers shows that the IRS approves a significant number of applications it would have rejected had the applications been subject to a slight amount of scrutiny."¹²⁹ Evidently many filers were acting without benefit of counsel: "From July through September 2015, TAS reviewed a representative sample of 408 organizations whose Form 1023-EZ applications were approved. The analysis showed that 149, or 37 percent, of the organizations in the sample did not satisfy the organizational test. Of these 149 organizations, 22 appeared to have an adequate purpose clause, but lacked a sufficient dissolution clause (where one was required), a condition the organizations could have easily corrected had they been advised to do so."¹³⁰ Her recommendations included that the IRS require Form 1023-EZ filers to submit their organizing documents and "provide a description of their actual or planned activities and . . . summary financial information such as past and projected revenues and expenses."¹³¹

On December 3, 2015, the IRS reported on its early experiences with the Form 1023-EZ.¹³² The report highlighted increased "EO customer satisfaction" ("organizations have responded positively to the form's abbreviated length, ease of completion, lower user fee and electronic submission for mat") and a severe reduction in the average processing time (13 days compared to 191 days for the traditional Form 1023).¹³³ Selecting three percent of applications for random predetermination review, reviewing agents might request additional information, notably: "for the organizing document with language required to meet the organizational test; a detailed description of past, present,

128. NAT'L TAXPAYER ADVOCATE SERV., 2015 ANNUAL REPORT TO CONGRESS, MOST SERIOUS PROBLEM #3 – FORM 1023-EZ: RECOGNITION AS A TAX-EXEMPT ORGANIZATION IS NOW VIRTUALLY AUTOMATIC FOR MOST APPLICANTS, WHICH INVITES NONCOMPLIANCE, DIVERTS TAX DOLLARS AND TAXPAYER DONATIONS, AND HARMS ORGANIZATIONS LATER DETERMINED TO BE TAXABLE 43 (2016), http://taxpayeradvocate.irs.gov/Media/Default/Documents/2015ARC/ARC15_Volume1_MSP_03_Form-1023-EZ.pdf (statement of Sunita Lough) ("We also note that from FY 2014 to FY 2015, the frequency with which EO Determinations employees referred IRC § 501(c)(3) organizations to TE/GE's EO Examination function increased almost ninefold.")

129. *Id.* at 37.

130. *Id.* at 42 (footnote omitted).

131. *Id.* at 44.

132. INTERNAL REVENUE SERV., FORM 1023-EZ FIRST YEAR REPORT (2015), https://www.irs.gov/pub/irs-tege/Form_1023_EZ_First_Year_Report.pdf.

133. *Id.* at 111–12.

and future activities; a schedule of revenues and expenses; and a detailed description of any transactions with donors or related entities.”¹³⁴ The report noted the need to address the phenomenon of “volume submitters,”¹³⁵ and concluded by declaring its intent to mitigate fundamental risk factors it identified from “implementing a streamlined application form based on attestations,” including:

- Decreased IRS involvement in applicant engagement and education.
- Insufficient information on the form for the IRS to make an accurate determination.
- Increased likelihood of fraud.
- Perception that applicants could be treated inconsistently.
- Possibility that application processing may be inadequate.¹³⁶

In 2016, the IRS will start a post-determination compliance program for Form 1023-EZ filers, “allow[ing] IRS to check compliance for small exempt organizations after a year or more in operation. In addition . . . IRS will use the findings from this compliance program to identify opportunities to further improve and adjust the Form 1023-EZ and processes” (including “requiring an independent attestation that total assets are less than \$250,000.”).¹³⁷

The 2015 report of the Advisory Committee to the TE/GE Commissioner (the ACT) highlighted the IRS’s lack of scrutiny of 1023-EZ filers (“Gen EZ”), and recommended expanding the Form 990-N.¹³⁸ The ACT report comments: “We recommend that the IRS consider increas-

134. *Id.* at 6.

135. *Id.* at 9 (“After identifying multiple applications being filed from the same pay.gov account, IRS continues to assess the behavior and potential impact of these volume submitters. Recent data analytics identified 41 submitters who sent in more than 10 applications, including four that submitted more than 100 applications and six that submitted more than 50.” These volume submitters “generated legitimate business questions regarding their degree of due diligence and that of the applicants, the depth of review for accuracy once the application was complete, uncertainty about the validity of the signature on the application and the motive and legitimacy of the volume submitters.”).

136. *Id.* at 9–10.

137. *Id.* at 10.

138. INTERNAL REVENUE SERV., ADVISORY COMM. ON TAX EXEMPT & GOV’T ENTITIES (ACT), 2015 REPORT OF RECOMMENDATIONS 89, 145 (2015) (in portion of the report titled “Exempt Organizations: The Redesigned Form 990: Recommendations for Improving its Effectiveness as a Reporting Tool and Source of Data for the Exempt Organization Community”), http://www.irs.gov/pub/irs-tege/tege_act_rpt_14.pdf (“In addition, because filing a Form 990-N likely will be the filing organization’s only contact with the IRS, the agency should engage in more education and outreach as part of the Form 990-N filing process.”).

ing the amount of information requested on the Form 990-N to give some indication of Form 990-N filers' activities and expenses. The Form 990-N filers include not only the Gen EZ members, but also other smaller tax-exempt organizations . . . that never have been through the exercise of preparing and filing a Form 990 to ensure that they are meeting a necessary public support test, refraining from engaging in impermissible activities, and undertaking other diligence that the Form 990 preparation process necessarily entails."¹³⁹ The report adds:

The IRS could also ask for information on the number of members of the organization's governing body and a brief statement of the organization's mission. As it is doing with a random, three percent selection of Form 1023-EZ applications, the IRS could ask information on the organization's assets, basis for exemption, transactions with related parties, or similar questions. The ACT believes that requesting more information with respect the Form 990-N would assist the IRS in its compliance efforts with these smaller organizations and well as to make the organizations more accountable for their operations and financial results.¹⁴⁰

However, such a revised filing—in contrast to the current Form 990-N (the e-Postcard)—would constitute a “return” that starts the statute of limitations.¹⁴¹

Both the exemption application (once recognition is granted) and the annual filings are public documents, but obviously the less that is collected, the less that is available without further inquiry. The application package of a successful Form 1023-EZ filer will provide little information both to the agency and to the general public. (Yin further cautions, “Submitting many short-form applications for different organizations that will exist for only a brief period – such as, for example, only through the end of the current election cycle – might be a simple way to ensure that they obtain tax-deductible contributions for all manner of nonqualifying activities and expenses.”¹⁴²). Transparency suffers not only because the public cannot tell whether (c)(3) status resulted from a Form 1023-EZ filing, but also because the IRS fails to

139. *Id.* at 146.

140. *Id.* at 146–47.

141. As explained in NATIONAL TAXPAYER ADVOCATE, 1 FISCAL YEAR 2016 OBJECTIVES REPORT TO CONGRESS 72 n. 13 (2016), “[b]ecause an e-Postcard does not contain sufficient data to calculate tax liability or determine tax-exempt status, and does not purport to be a return, “the filing of a complete Form 990 or Form 990-EZ, rather than the submission of an annual electronic notification, is the filing of a return that starts the period of limitations for assessment under section 6501(g)(2).” See also Treas. Reg. § 1.6033-6(c)(4); T.D. 9366, 2007-52 I.R.B. 1232, 1233.

142. Yin, *supra* note 101, at 269.

require a full Form 1023 from an organization that has outgrown its small financial status.

If exemption granted to a Form 1023-EZ applicant were to be made provisional, the “501(c)(3)-EZ” organization would have to file at least another Form 1023-EZ at the end of the probationary period. Over a decade ago, the staff of the Senate Finance Committee published a discussion draft on exempt-organization topics.¹⁴³ Its first proposal essentially would have required all 501(c)(3) organizations to reapply for exemption every five years. In comments presented at a Senate Finance Committee staff roundtable on its white paper, co-author Evelyn Brody endorsed this proposal—if it were limited to new (c)(3)’s.¹⁴⁴ Specifically, Brody wrote:

[T]he discussion draft[] propos[es] to require, once every five years, that each exempt organization file “such information as would enable the IRS to determine whether the organization continues to be organized and operated exclusively for an exempt purposes (i.e. whether the original determination letter should remain in effect)” – such information becoming publicly available. Regardless of whether the Service examines the submitted material in a particular case, assembling this information will be a salutary exercise for the governing board and management of the organization. Perhaps most important, a new organization assessing its first five years of existence will be compelled to face the question of whether it is even viable to continue. It might be appropriate, however, to limit this requirement only to start-up organizations and, perhaps, small organizations Established organizations – particularly those that are accredited and regularly reviewed by another body (as described elsewhere in the draft) – might find such an exercise duplicative and resource-wasting.

An argument can be made that the IRS needs no legislation to adopt this suggestion: it created the 1023-EZ and it can take it away.¹⁴⁵ If, however, the requirement to obtain IRS recognition of § 501(c)(3) exemption under § 508 is read as a one-time obligation, then the larger battle over tax reform makes it risky to count on congressional enactment of this proposal.

143. See S. FIN. COMM., SENATE FINANCE ISSUES DISCUSSION DRAFT ON REFORMS FOR EOS, S. DOC. NO. 2004-12896 (2004).

144. See Evelyn Brody, *Law Professor Presents White Paper on Charity Oversight*, TAX NOTES TODAY (2004).

145. Compare the IRS’s old approach of granting only an advance ruling period for non-private foundation status; five years after exemption was granted, the Form 990 filed by the (c)(3) had to demonstrate that the organization had achieved public charity status based on actual public support.

Of course, given that the Form 1023-EZ is optional, even a small applicant for 501(c)(3) status could file a Form 1023. Such an applicant would resolve uncertainties over its status for foundation grants,¹⁴⁶ and its statement of activities in the Form 1023 could protect it from retroactive revocation of exemption.¹⁴⁷ Not to mention that the charity could publicly signal that it had carefully considered the desirability and long-term viability of its undertaking.

CONCLUSION

On July 21, 2015, President Barack Obama commented to Jon Stewart, host of *The Daily Show* on Comedy Central: “When there was that problem with the IRS, everyone jumped . . . , saying, ‘Look, you’ve got this back office, and they’re going after the Tea Party.’ Well, it turned out, no, Congress had passed a crummy law that didn’t give people guidance in terms of what it was they were trying to do. They did it poorly and stupidly.” The president added: “The truth of the matter is that there was not some big conspiracy there. They [(the IRS)] were trying to sort out these conflicting demands. You don’t want all this money pouring through not-for-profits, but you also want to make sure everybody is being treated fairly.” Alluding to the bigger problem, he emphasized: “Now, the real scandal around the IRS right now is that it has been so poorly funded that they cannot go after these folks who are deliberately avoiding tax payments”¹⁴⁸

Jon Stewart, of course, did not point out to the president that ambiguous concepts—such as “unrelated business activity” and “educational”¹⁴⁹—are the hallmark of the federal tax rules applicable to tax-

146. See Diane Freda, *Treasury to Review Grantor, Contributor Reliance Standard Related to Form 1023-EZ*, DAILY TAX REPORT (Mar. 19, 2015); see also Rev. Proc. 2016-5, 2016-1 I.R.B. § 11.02(2) (2016).

147. However, the absence of a statement of activities on the Form 1023-EZ means that the IRS would have to independently determine whether the applicant failed the organizational and operational tests. See Rev. Proc. 2016-5, 2016-1 I.R.B. § 12 (2016). A misstatement of material information is grounds for retroactive revocation. Part .01(3) adds: “A misstatement of material information includes an incorrect representation or attestation as to the organization’s organizational documents, the organization’s exempt purpose, the organization’s conduct of prohibited and restricted activities, or the organization’s eligibility to file Form 1023-EZ.”

148. The Daily Show with Jon Stewart, *Barack Obama Extended Interview*, COMEDY CENTRAL (July 21, 2015), <http://thedailyshow.cc.com/extended-interviews/qhcg6g/exclusive-barack-obama-extended-interview>.

149. *Big Mama Rag, Inc. v. United States*, 631 F.2d 1030, 1037 (D.C. Cir. 1980) (declaring Internal Revenue Code, 26 C.F.R. § 1.501(c)(3)-1(d)(3), which defines “educational,” unconstitutionally vague).

exempt organizations, and have defied specific definition since their enactment.

The IRS has taken a series of major organizational and procedural steps, clearly moving as quickly as it can to address the May 2013 TIGTA Report's recommendations and to align the Exempt Organizations Division (and the Employee Plans Division) with the organizational structures of the rest of the IRS National Office. These changes, though, are being developed by an entirely new cadre of senior management, virtually all of whom lack significant experience in the function or with the tasks required to administer the relevant substantive sections of the Internal Revenue Code.

In addition, the agency is proceeding piecemeal, focusing initially on the exemption-application processing function, to be followed at some point by a review of the examination function. In view of the huge amounts of funds flowing into the nonprofit sector, particularly to social welfare organizations exempt under section 501(c)(4),¹⁵⁰ the IRS's sense of urgency is understandable. However, this emphasis on granting recognition of exemptions now and (possibly) asking questions later does not seem sustainable. The nonprofit sector and practitioners should be alert to developments to target noncompliance, as they are likely to occur quickly, and without an opportunity for public comment and discussion. In addition, the decoupling of the enforcement function from the interpretative function, now located in a different organization unit (the Office of Chief Counsel), suggests that there may be a greater risk for inconsistent or incorrect positions being taken in IRS audits.

As for small charities, regardless of whether Congress or the IRS adopts the five-year provisional-exemption proposal described in Part III, the agency should expand information collection. Importantly, a charity that grows sufficiently—which could happen even before five years pass—will have to file a Form 990-EZ or even a Form 990. Thus, the IRS should require a successful Form 1023-EZ applicant, when it first files one of those information returns, to submit the organizational documents and certain other information (notably, about activities and related party transactions and relationships) that would have been required on a full Form 1023 application. In addition, the IRS should continue sampling to ensure the eligibility of 1023-EZ applicants.

150. Kim Barker, *How Nonprofits Spend Millions on Elections and Call it Public Welfare*, PROPUBLICA (Apr. 18, 2012, 10:25 PM), <http://www.propublica.org/article/how-nonprofits-spend-millions-on-elections-and-call-it-public-welfare>.

The bigger question—should the IRS be the locus of federal regulation of charities?—might more usefully be narrowed to “should the IRS be the locus of regulation for political activity by tax-exempt organizations?”¹⁵¹ If significant abuse arises, particularly if due even in part to the reduction in scrutiny of applications for tax-exempt status and in audit enforcement, one of us has proposed that it might be appropriate to move the entire regulatory function over tax-exempt organizations to a different governmental or quasi-governmental structure.¹⁵²

151. Compare Paul Streckfus, Editor, EO Tax Journal, Email Update 2015–96 (Monday, May 18, 2015): “I suspect the reality is that most members of Congress, of both parties, are quite happy with the status quo. What fun is bashing the IRS if there is no IRS to bash? Keep EO in IRS and there will always be some group saying the IRS is badgering them, targeting them, denying them their constitutional rights, etc.”, with Letter from Larry Gibbs, former Comm’r, I.R.S., to Paul Streckfus, Editor, EO Tax Journal, Email Update 2014-134 (Tuesday, July 8, 2014): “I suspect many Republicans and Democrats presently may favor taking the EO function out of the IRS, so long as the authority and responsibility for administering political campaign activities go with it. I further suspect those who have been trying to use the EO provisions for purposes never intended in order to accomplish their political objectives would be happy to deal with a smaller agency that may be less able than the IRS to stand up to the pressures like the political pressures presently arrayed against the IRS in the (c)(4) area.”

152. See Owens, *supra* note 6, at 21, 31; see also Lloyd Hitoshi Mayer, “*The Better Part of Valour is Discretion*”: Should the IRS Change or Surrender Its Oversight of Tax-Exempt Organizations?, COLUM. J. TAX L. (forthcoming 2016) (manuscript at 45), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2658325.

