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A photograph of the University of Pittsburgh School of Law building at night. The building is a modern, multi-story structure with many windows illuminated from within, creating a warm glow against the dark sky. Bare trees are in the foreground, and a few people can be seen walking on the sidewalk. The overall scene is a nighttime urban setting.

Working Paper No. 2022-13  
May 2022

## **Written Testimony of Philip Hackney for the Hearing on Laws and Enforcement Governing the Political Activities of Tax-Exempt Entities (U.S. Senate Finance Committee Subcommittee on Taxation and IRS Oversight, May 4, 2022)**

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**Written Testimony of Philip Hackney**  
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**U.S. Senate Finance Committee Subcommittee on Taxation and IRS**  
**Oversight**  
**Laws and Enforcement Governing the Political Activities of Tax-Exempt**  
**Entities.**  
May 4, 2022

Chair Whitehouse, Ranking Member Thune, members of the committee, thank you for inviting me here today to speak with you about a matter of great importance to the operation of the democratic order of the United States. I understand you have asked me to speak to the issue of federal income tax laws and IRS enforcement related to the political activity of tax-exempt entities.

I am an associate professor of law at the University of Pittsburgh School of Law where I primarily teach tax law courses. I specialize in the federal tax treatment of nonprofit organizations. From 2006-2011, I worked in the Office of the Chief Counsel of the IRS in Washington D.C. overseeing the tax-exempt sector. There I helped to oversee the drafting of regulations, the overall program of auditing tax exempt organizations, and IRS litigation on matters related to tax laws applicable to nonprofits and government entities. That work necessarily interacted in a robust way with politics. The IRS oversees dark money organizations, section 527 political organizations, and charities that engage in politics in its largest sense. Today, I write, research, and speak about these organizations and the regulatory regime applicable to them.<sup>1</sup>

I understand the committee is interested in whether the tax laws and IRS enforcement are up to the task of overseeing the tax issues associated with the political activities of tax-exempt organizations. While from my writing you can see that I think the tax laws governing the tax-exempt realm are wanting, our overall legal structure is not bad. It is justifiable at least. Where we fall down as a nation in this space is in the enforcement. As I will discuss below, we do not allocate enough resources to this arena, and we do not institutionally offer the support necessary to enforce these laws. These failures do not favor one party over the other but favor those interests in the country with the means and the willingness to abuse that structure. Primarily that redounds to certain wealthy interests.

Within the tax structure of politics in its broadest sense it is worth noting that neither political campaign expenditures nor lobbying expenditures are deductible under

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<sup>1</sup> I note that in addition to my experience at the IRS this testimony is informed in significant part by articles I have written including Philip Hackney, *Political Justice and Tax Policy: The Social Welfare Organizations Case*, 8 TEX. A&M L. REV. 271 (2021) [hereinafter *Political Justice*] and Philip Hackney, *Dark Money Darker? IRS Shuttles Collection of Donor Data*, 25 FLA. TAX REV. 140 (2021) [hereinafter *Dark Money Darker*]. I also rely in small part on testimony I provided to the Pennsylvania House Committee on Oversight February 7, 2022.

the Internal Revenue Code (“Code”).<sup>2</sup> In effect, Congress sees these as personal expenditures that ought not receive a subsidy through the income tax. Indeed, Congress forces the contributor of appreciated property, such as corporate stock, to a section 527 political organization to recognize gain on that transfer under the Code.<sup>3</sup> This is distinctly different from most contributions of property. Gifts of appreciated property in general do not trigger an income tax gain.<sup>4</sup>

In this testimony, first, I will describe the tax law that applies to these organizations and then I will discuss the enforcement environment including both a description of the resources available to the IRS and a discussion of the institutional challenges faced by the IRS. As you will see in Part III, the IRS does not have the budget to enforce the tax laws on the books, but also often fails to make use of simple information to enforce these laws that matter both in collection of the revenue and our democratic order.

## **I. Tax-Exempt Organizations and Politics Introduction**

The IRS tax-exempt division oversees a range of nonprofit entities that engage in various types of political activity in its broadest sense. Some of the activities of these organizations is also overseen by the FEC. The entities I will focus upon include section 527 political organizations, section 501(c)(3) charitable organizations, section 501(c)(4) social welfare organizations, and section 501(c)(6) business leagues.<sup>5</sup>

When I say political activity in its broadest sense, I am referring to a combination of intervention in a political campaign, lobbying, and activities close to both, sometimes referred to as issue advocacy.

In tax law, intervention in a political campaign has its most salient meaning with respect to charitable organizations.<sup>6</sup> This *political campaign intervention* prohibition is colloquially referred to as the ‘Johnson Amendment’. It means the exempt organization cannot participate or intervene, “directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office.”<sup>7</sup> In other words, in campaigns for public office (federal, state, and local) the charity itself cannot directly or

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<sup>2</sup> 26 U.S.C. § 162(e). The U.S. Supreme Court upheld the prohibition on deducting political campaign expenses in *Cammarano v. United States*, 358 U. S. 498 (1959).

<sup>3</sup> 26 U.S.C. § 84.

<sup>4</sup> See BORIS I. BITTKER & LAWRENCE LOKKEN, *FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS*, ¶ 40.3 (2021, WG&L). I have argued Congress ought subject contributions of appreciated assets to social welfare organizations to the income tax on the gain just as it does to section 527 organizations under 26 U.S.C. § 84. See *Political Justice*, *supra* note 1, at 328.

<sup>5</sup> Section 501(c)(5) labor unions might be listed here as well, but because of robust regulation and disclosure regarding their activity via other regulatory bodies, the IRS role in oversight of these organizations is much less significant. See, e.g., *LABOR-MANAGEMENT REPORTING AND DISCLOSURE ACT* 29 U.S.C. §§ 401-531 (2012). Extensive reports about the financial activities of many labor unions are available on the Department of Labor website, at <https://www.dol.gov/agencies/olms/public-disclosure-room>.

<sup>6</sup> 26 U.S.C. § 501(c)(3).

<sup>7</sup> Treas. Reg. § 1.501(c)(3)-1(c)(3)(iii).

indirectly encourage the public to vote for or against candidates. I use that definition when I refer to *political campaign intervention*.

*Lobbying* refers to efforts to encourage members of a legislative body to propose, support, or oppose legislation.<sup>8</sup> Finally, there is *issue advocacy*. In issue advocacy, an organization may educate the public broadly about a political topic with the intention of swaying the public toward a particular political solution. In its most specific context, issue advocacy involves advocating about a political solution while simultaneously identifying a candidate for office. Typically, these communications let the reader or viewer draw their own conclusion about whether to vote for or against that candidate. This sometimes leads to political campaign intervention.

## II. Tax Exempt Organizations and Politics, the Law

This Part II will describe section 527 political organizations, section 501(c)(3) charities, section 501(c)(4) social welfare organizations, section 501(c)(6) business leagues, and then discuss information return obligations of tax-exempt organizations.

### a. Section 527 Political Organizations

Prior to the 1970s, the IRS mostly ignored the tax implications of political committees or organizations.<sup>9</sup> It saw the contributions to a political committee as a gift and therefore non-taxable to the entity or individual.<sup>10</sup> Congress enacted section 527 of the Code in 1975 to manage the taxable matters created by these political committees and organizations.<sup>11</sup> In 2000 and 2002, Congress amended the statute to require disclosure of donors from section 527 organizations that did not specifically come within the FEC's jurisdiction.<sup>12</sup>

Political organizations are organized and operated primarily for what is called an "exempt function." An exempt function includes the "function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization."<sup>13</sup> A section 527 organization still maintains a tax-exempt status, but is subject to a complicated tax, primarily on its investment income. A section 527 organization that anticipates receiving gross receipts in excess of \$25,000 a year generally must give notice to the IRS within 24 hours of its establishment.<sup>14</sup> Unlike a

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<sup>8</sup> Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii).

<sup>9</sup> I.R.S., I. IRC 527 – Political Organizations, Exempt Organizations CPE Text (1989), <https://www.irs.gov/pub/irs-tege/eotopici89.pdf>.

<sup>10</sup> See, e.g., Rev. Proc. 68-19, 1968-1 C.B. 810.

<sup>11</sup> Act of Jan. 3, 1975, Pub. L. No. 93-625, § 10, 88 Stat. 2108, 2116-19 (codified as amended at § 527); see also CONGRESSIONAL RESEARCH SERVICE, POLITICAL ORGANIZATIONS UNDER SECTION 527 OF THE INTERNAL REVENUE CODE (2008), <https://crsreports.congress.gov/product/pdf/RS/RS21716/4>.

<sup>12</sup> P.L. 106-230; P.L. 107-276; see also CONGRESSIONAL RESEARCH SERVICE, POLITICAL ORGANIZATIONS UNDER SECTION 527 OF THE INTERNAL REVENUE CODE (2008), <https://crsreports.congress.gov/product/pdf/RS/RS21716/4>.

<sup>13</sup> 26 U.S.C. § 527.

<sup>14</sup> They must file with the IRS a Form 8871 found here <https://www.irs.gov/forms-pubs/about-form-8871>.



social welfare organizations, a section 527 organization must publicly disclose substantial information about its receipts of contributions and expenditures.<sup>15</sup> Congress considered extending these same disclosure obligations to social welfare organizations as well, but never has.<sup>16</sup> The IRS has provided guidance as to when certain activity is considered an exempt function activity under section 527 for social welfare organizations as well as business leagues and labor unions.<sup>17</sup> If a social welfare organization, business league or labor union engages in activities categorized as exempt function activity, the organization is subject to the tax under section 527(f). An organization described in section 501(c) could alternatively create a segregated fund to operate as a political organization under section 527.<sup>18</sup>

### *b. Charitable Organizations*

Charitable organizations are exempt from tax under section 501(a) of the Code as described in section 501(c)(3) of the Code.<sup>19</sup> A charitable organization must be organized and operated exclusively for religious, charitable, scientific, or educational purposes, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.<sup>20</sup> A charitable organization may not engage in more than an insubstantial amount of lobbying and is completely prohibited from intervening in a political campaign.<sup>21</sup> Finally, the organization cannot violate public policy.<sup>22</sup>

An organization that qualifies as a charitable organization obtains a number of important benefits. The first is that it is able to accept tax-deductible contributions from its donors.<sup>23</sup> Though generally only relatively high-income donors are today able to make use of the charitable contribution deduction,<sup>24</sup> where a donor is able to take advantage of the deduction, the government effectively makes a big part of the contribution to the charity – equal to the top marginal tax rate of the donor.<sup>25</sup> In other

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<sup>15</sup> 26 U.S.C. § 527(j). Note that Political Committees that already have the obligation to file with the FEC do not have to comply with the section 527(j) disclosure requirements. *See also* Form 990, Return for Organization Exempt from Income Tax, Schedule B Schedule of Contributors Instructions; Form 8872 <https://www.irs.gov/forms-pubs/about-form-8872>.

<sup>16</sup> See, e.g., Donald Tobin, *Campaign Disclosure and Tax-Exempt Entities: A Quick Repair to the Regulatory Plumbing*, 10 ELECTION L.J. 427, 430 & FN 21 (2011) (citing H. Rep. No. 106-702, at 9–11 and H. Rep. No. 106-702, at 40–41).

<sup>17</sup> Rev. Rul. 2004–6, 2004–1 C.B. 328.

<sup>18</sup> 26 U.S.C. § 527(f)(3).

<sup>19</sup> 26 U.S.C. § 501(a) & (c)(3).

<sup>20</sup> 26 U.S.C. § 501(c)(3).

<sup>21</sup> *Id.*

<sup>22</sup> *Bob Jones Univ. v. U.S.*, 461 U.S. 574 (1983) (holding organization not exempt from income tax as a charitable organization because it violated public policy by racially discriminating against students by restricting dating among students of different races).

<sup>23</sup> 26 U.S.C. § 170.

<sup>24</sup> This is because Congress significantly raised the standard deduction in the 2017 Tax Act, Sec. 11021, Pub.L. 115-7 (Dec. 22, 2017). The Tax Policy Center for instance estimates that it reduced the number of households deducting their charitable contributions from 21% of households to about 9% of households. <https://www.taxpolicycenter.org/briefing-book/how-did-tcja-affect-incentives-charitable-giving>

<sup>25</sup> *See* JOINT COMMITTEE ON TAXATION, PRESENT LAW AND BACKGROUND RELATING TO THE FEDERAL TAX TREATMENT OF CHARITABLE CONTRIBUTIONS, JCX-2-22, 34 (March 17, 2022),

words, if a donor had a 40% top marginal tax rate and made a \$1,000 contribution to a charitable organization, the government contributes \$400 to the organization and the donor contributes \$600. Contributions to charitable organizations are also deductible from the trust, gift, and estate taxes.<sup>26</sup> Additionally, a charitable organization generally owes no tax on its earnings unless it operates an unrelated trade or business.<sup>27</sup> Charities are allowed to issue tax-exempt bonds.<sup>28</sup> There are many other benefits that come with the charitable designation at the federal, state and local level including exemptions from property tax and state and local income tax.

Though occasionally charitable organizations intervene in a political campaign in a way that is clear,<sup>29</sup> many charitable organizations engage in political activity in its broadest sense. In the political sphere, most charitable organizations rely upon either a religious or educational purpose to support their claim to exemption. Religious organizations will often assert that they are speaking from a religious perspective to lobby, engage in issue advocacy, or sometimes to advocate for a candidate in a political campaign. Educational organizations rely upon the fact that charitable educational organizations can educate “the public on subjects useful to the individual and beneficial to the community.”<sup>30</sup> There are many think tank advocacy groups that today qualify under section 501(c)(3) by educating the populace about important ideas to our governance. For instance, Heritage Foundation, the conservative think tank, is recognized by the IRS as a charitable organization,<sup>31</sup> as is Center for American Progress, the progressive think tank.<sup>32</sup> While I am not arguing that either of these organizations engages in political campaign intervention, they are examples of organizations involved in the broad sense of political activity.

As noted above, a charitable organization that seeks to maintain its exempt status may not intervene in a political campaign.<sup>33</sup> This means that the organization’s representatives *when speaking for the charity* may not directly or indirectly encourage the public to vote for or against a candidate for political office. This definition is broader than the election activity overseen by the FEC.<sup>34</sup> Notably, if the charity were able to intervene in a political campaign, donors would have a means to deduct their political campaign activity. More problematically, those in the highest tax brackets would be

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<https://www.jct.gov/publications/2022/jcx-2-22/> (making this essential point: “the value of the tax deduction to the taxpayer is the amount of the donation multiplied by the taxpayer’s marginal tax rate”).

<sup>26</sup> 26 U.S.C. §§ 642, 2055, and 2522.

<sup>27</sup> 26 U.S.C. § 511.

<sup>28</sup> 26 U.S.C. § 145.

<sup>29</sup> See, e.g., Eugene Scott, [Pastors Take to Pulpit to Protest IRS Limits on Political Endorsements](#), CNN (October 1, 2016).

<sup>30</sup> Treas. Reg. § 1.501(c)(3)-1(d)(3).

<sup>31</sup> Heritage Foundation, Form 990 (2019),

[https://projects.propublica.org/nonprofits/display\\_990/237327730/02\\_2021\\_prefixes\\_23-25%2F237327730\\_201912\\_990\\_2021021717708700](https://projects.propublica.org/nonprofits/display_990/237327730/02_2021_prefixes_23-25%2F237327730_201912_990_2021021717708700).

<sup>32</sup> Center for American Progress, Form 990 (2019),

[https://projects.propublica.org/nonprofits/display\\_990/300126510/02\\_2021\\_prefixes\\_27-31%2F300126510\\_201912\\_990\\_2021021917725620](https://projects.propublica.org/nonprofits/display_990/300126510/02_2021_prefixes_27-31%2F300126510_201912_990_2021021917725620).

<sup>33</sup> 26 U.S.C. § 501(c)(3).

<sup>34</sup> The best statement from the IRS of what it views as a violation of this limitation is found in Rev. Rul. 2007-41, 2007-25 I.R.B. 1421.

most advantaged by such a system. In effect, this would mean the government would support the political interests of the wealthy at forty cents on the dollar and most everyone else at 0 cents on the dollar. The IRS has tools in the Code to apply a tax on a charity, and its management, when the charity violates this limitation.<sup>35</sup>

Congress also limits the amount of lobbying in which a charity can engage.<sup>36</sup> The Code provides that “no substantial part of the activities” can consist in “carrying on propaganda, or otherwise attempting, to influence legislation.”<sup>37</sup> The regulations suggest that lobbying involves “contacting legislators or urging the public to contact them to propose, support, or oppose legislation, or advocating the adoption or rejection of legislation.”<sup>38</sup> It is not clear how much lobbying is too much to become a “substantial part.”<sup>39</sup> Part of the challenge is determining how to think about activities. Similar to political campaign intervention, should activities be measured in time, expenditure, or something else? There is some guidance, as Congress has implicitly set that amount at not greater than 20 percent of expenditures when it enacted section 501(h) of the Code.<sup>40</sup> This allows charities to elect this regime such that the charity will know beforehand whether or not it will be complying with the law. But charities who have not elected the section 501(h) regime are still governed by the “substantial part” of activities language.

These limitations have passed Constitutional muster. For instance, the U.S. Supreme Court upheld the constitutionality of the limitation on lobbying under the First Amendment and the Equal Protection clause in *Regan v. Taxation with Representation*.<sup>41</sup> In an opinion by Justice Rehnquist, the Court stated: “[w]e held that Congress is not required by the First Amendment to subsidize lobbying. In these cases, as in *Cammarano*, Congress has not infringed any First Amendment rights or regulated any First Amendment activity. Congress has simply chosen not to pay for TWR’s lobbying.”<sup>42</sup> The Court highlights that those who run a charity have the option of also operating a section 501(c)(4) social welfare organization in order to engage in substantial lobbying, simply without the ability for donors to deduct their contributions.<sup>43</sup> In a footnote, the Court notes that the IRS allows the same people who control the charity to also control the social welfare organization, as long as the organizations scrupulously account for the monies and ensure no monies intended for the charity are used to support the social welfare organization’s activity.<sup>44</sup> This theme of

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<sup>35</sup> 26 U.S.C. § 4955. Additionally, in egregious situations, the IRS can take immediate action under 26 U.S.C. §§ 6852 and 7409.

<sup>36</sup> 26 U.S.C. § 501(c)(3).

<sup>37</sup> *Id.*

<sup>38</sup> Treas. Reg. § 1.501(c)(3)-1(c)(3). It also notes this applies as well to an organization whose purpose can only be attained via legislation.

<sup>39</sup> *Haswell v. United States*, 500 F.2d 1133 (Ct. Cl. 1974), *cert. denied*, 419 U.S. 1107 (1975) (finding a range between 16.6% and 20.5% of total expenditures over four years to be a substantial part).

<sup>40</sup> 26 U.S.C. §§ 501(h) & 4911(c)(2).

<sup>41</sup> *Regan v. Taxation with Representation*, 461 U.S. 540 (1983) (*citing* *Cammarano v. United States*, 358 U.S. 498, 513 (1959)).

<sup>42</sup> *Id.* at 546.

<sup>43</sup> *Id.* at 544.

<sup>44</sup> *Id.* at 544 FN 6.

the flexibility of the tax exempt organization structure to accomplish various purposes related to politics was relied upon by the D.C. Circuit Court of Appeals to uphold the Constitutionality of the prohibition on political campaign activity of a church in *Branch Ministries v. Rossotti*.<sup>45</sup>

In addition to the political aspects of charities, much of the regulatory architecture found in section 501(c)(3) works simultaneously to prevent fraud on charity and prohibit evasion of income tax. For instance, Congress prohibits the inurement of the earnings of the charity to a private shareholder or individual.<sup>46</sup> This both protects funds set aside for charitable purpose and ensures that the organization is not operating a tax shelter for the individuals who control the organization. The Code is designed to only provide the benefits given to charitable organizations that are engaged in benefitting the public and not avoiding the income tax.<sup>47</sup> In addition to the inurement prohibition, Treasury regulations require that charities be operated for a public purpose and not a private one.<sup>48</sup> This limits the amount of private benefit that a charity can provide.<sup>49</sup> For instance, a charity cannot be set up to dredge a waterway where the primary beneficiaries are private homeowners rather than the public at large.<sup>50</sup> Again, generally this is designed to prevent abuse of charities by directing them away from working to help private individuals and businesses instead of and towards helping charitable beneficiaries. One more provision is worth noting here, Congress prevents certain charities from engaging in what are known as excess benefit transactions.<sup>51</sup> In general, this provision imposes a tax upon an individual who has some control over a charity and uses that control to take from that charity something of value to which they are not entitled.<sup>52</sup>

In order to hold charities accountable for proving their exemption, to ensure the proper collection of tax revenue, and to provide important information to the public, charities must annually file a Form 990 with the IRS.<sup>53</sup> I discuss this more below in Part II(d).

### *c. Dark Money Organizations*

What are ‘dark money organizations’ and how do they relate to tax and political activities of tax-exempt organizations? Dark money organizations refer to tax-exempt

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<sup>45</sup> *Branch Ministries v. Rossotti*, 211 F.3d 137, 143 (D.C. Circuit Ct. of Apps. 2000) (noting that the section 501(c)(3) church leaders could form a section 501(c)(4) organization, which in turn could form a Political Action Committee to speak about a campaign).

<sup>46</sup> 26 U.S.C. § 501(c)(3); Treas. Reg. §§ 1.501(c)(3)-1(c)(2) & 1.501(a)-1(c) (defining private shareholder or individual).

<sup>47</sup> See Treas. Reg. § 1.501(c)(3)-1(d)(1).

<sup>48</sup> Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

<sup>49</sup> *Id.*; see also Treas. Reg. § 1.501(c)(3)-1(d)(1)(iii) examples.

<sup>50</sup> See *Ginsberg v. Commissioner*, 46 T.C. 47 (1966).

<sup>51</sup> 26 U.S.C. § 4958. This provision applies to public charities (not private foundations) and social welfare organizations. Congress subjects private foundations to a more restrictive regime including significant limitations on self-dealing under 26 U.S.C. § 4941.

<sup>52</sup> *Id.*

<sup>53</sup> 26 U.S.C. § 6033.



organizations that engage in political advocacy that may rise to the level of political campaign intervention. The moniker “dark” means that the public has little access to knowledge about who funds these organizations because the organization typically does not publicly disclose contributions received under campaign finance laws, nor publicly disclose via the IRS as a section 527 political organization. Social welfare organizations, described in section 501(c)(4), and business leagues, described in section 501(c)(6), are the common tax-exempt organizations that fit in the dark money category. Each of these organizations is exempt from the income tax under section 501(a). Though the IRS used to require dark money organizations to file information about substantial donors with the IRS on Schedule B to the Form 990, in 2020, the IRS recently ended the requirement.<sup>54</sup>

What is the benefit of being a tax-exempt social welfare organization or business league? These organizations are unable to accept charitable contributions deductible by the donors under section 170 of the Code. However, just like a charity, money earned in one of these exempt organizations is not subject to the federal income tax as long as the activity is consistent with the organization’s exempt purpose.<sup>55</sup> Those who contribute to a social welfare organization, or a business league may be able to deduct contributions to the organization if the expense qualifies as a business expense,<sup>56</sup> as it typically does in the case of business league dues, or if the expense qualifies for some other deduction. Additionally, a donor can contribute appreciated property like stock and not trigger gain for tax purposes. Conversely, when such property is contributed to a section 527 political organization, gain is triggered to the donor.<sup>57</sup> This provides a way of obtaining a deduction of a sort and makes the dark money organization a more desirable destination for such assets than a political organization. Finally, Congress has clarified that the gift tax does not apply to contributions to either a social welfare organization or a business league.<sup>58</sup>

One other commonality of these two organizations is that if either engages in exempt function activity as that term is defined in section 527 then as noted above in Part II(b), the exempt organization owes a tax under section 527(f).<sup>59</sup> The amount of that tax is set at the lesser of net investment income or the expenditure on the exempt function activity.<sup>60</sup> If there is no discernible expense to point to, there is no tax; similarly, if there is no net investment income in the year there is no tax as well. In Revenue Ruling 2004-6 the IRS provided guidance on when social welfare organizations, business leagues and labor unions engage in too much exempt function activity and become subject to the disclosure rules of section 527.<sup>61</sup>

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<sup>54</sup> 85 Fed. Reg. 31959 (May 28, 2020) (codified at 26 CFR 56) T.D. 9898. *See also Dark Money Darker*, *supra* note 1.

<sup>55</sup> 26 U.S.C. § 501(a), (c)(4), (6). An exempt organization that operates an unrelated business is subject to the unrelated business income tax though under 26 U.S.C. § 511.

<sup>56</sup> 26 U.S.C. § 162.

<sup>57</sup> *Cf.* 26 U.S.C. § 84 (donor who contributes appreciated property to 26 U.S.C. § 527 political organization owes income tax on the gain associated with the appreciated property).

<sup>58</sup> 26 U.S.C. § 2501(a)(6).

<sup>59</sup> 26 U.S.C. § 527.

<sup>60</sup> 26 U.S.C. § 527(f).

<sup>61</sup> Rev. Rul. 2004-6, 2004-1 C.B. 328.

### i. *Social welfare organizations*

Social welfare organizations include “[c]ivic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare . . . and no part of the net earnings of such entity inures to the benefit of any private shareholder or individual.”<sup>62</sup> The regulations suggest a social welfare purpose is furthered through “bringing about civic betterments and social improvements.”<sup>63</sup> One court suggested that such a purpose is found in “a community movement designed to accomplish community ends.”<sup>64</sup>

Studies suggest political organizations in number make up a small part of the social welfare sector.<sup>65</sup> Social welfare organizations also include health maintenance organizations, civic social clubs like Kiwanis and Rotary clubs, homeowners’ associations, and kid’s sports clubs.<sup>66</sup> Still, social welfare organizations participate in political activity in its broadest sense and inject substantial dollars into that world. Some of that political work furthers a social welfare purpose. For instance, lobbying can further a social welfare purpose.<sup>67</sup> However, a social welfare organization does not further its purpose when it intervenes in a political campaign.<sup>68</sup>

Though the statute uses the term “exclusively” when describing how much a social welfare organization must further its exempt purpose, Treasury regulations state that a social welfare organization must “primarily” further a social welfare purpose.<sup>69</sup> When the U.S. Supreme Court interpreted similar “exclusively” language in the context of a charitable organization and social security it stated: “an organization must be devoted to [its exempt] purposes exclusively. This plainly means that the presence of a single non-[exempt] purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly [exempt] purposes.”<sup>70</sup> The Second Circuit Court of Appeals in a social welfare organization case, *Contracting Plumbers*, explicitly rejected the idea that the regulation by using the term “primarily” had liberalized the exclusively standard for a social welfare organization.<sup>71</sup> The court stated: “we adhere to the rule that the presence of a single substantial non-exempt purpose precludes exempt status regardless of the number or importance of the exempt purposes.”<sup>72</sup> In fact, when the IRS rejects the application of a charity or a social welfare

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<sup>62</sup> *Id.*

<sup>63</sup> Treas. Reg. § 1.501(c)(4)-1(a)(2).

<sup>64</sup> *Erie Endowment v. United States*, 316 F.2d 151, 156 (3d Cir. 1963).

<sup>65</sup> JEREMY KHOULISH, FROM CAMPS TO CAMPAIGN FUNDS: THE HISTORY, ANATOMY AND ACTIVITY OF 501(C)(4) ORGANIZATIONS, URBAN INSTITUTE, 6 (2016).

<sup>66</sup> *Id.*

<sup>67</sup> Rev. Rul. 68-656, 1968-2 C.B. 216.

<sup>68</sup> Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii).

<sup>69</sup> *Id.*

<sup>70</sup> *Better Business Bureau of Washington D.C. v. U.S.*, 326 U.S. 279, 283 (1945). This decision predates the implementation of the unrelated business income tax. Ellen P. Aprill, *The IRS’s Tea Party Tax Row: How ‘Exclusively’ Became ‘Primarily’*, Pac. Standard (June 7, 2013), <http://www.psmag.com/politics/the-irss-tea-party-tax-row-how-exclusively-became-primarily-59451/>.

<sup>71</sup> *Contracting Plumbers Co-op. Restoration Corp. v. United States*, 488 F.2d 684, 686 (2d Cir. 1973).

<sup>72</sup> *Id.*

organization and issues a denial letter, it typically uses this formulation, i.e., “you are operated for a *substantial* non-exempt purpose.”<sup>73</sup> How is the statutory and regulatory language operationalized? In other words, what does it mean to be exclusively operated for a social welfare purpose? How do you measure that? Some attorneys have operated on the belief that if an organization can maintain its exempt status if it makes sure to engage in more than fifty percent of expenditures that further its exempt purpose annually.<sup>74</sup> A corollary to this would be that a social welfare organization can spend 49% of its time and expenditures on political campaign intervention, as long as the other 50 + .1 percent is focused on social welfare activity. This position seems to cut against the language of the Court in *Better Business Bureau*: an activity that makes up 49% of an organizations purpose would seem to “substantial in nature.”

It can be difficult for the IRS to make the call between activity that might be considered issue advocacy and activity that crosses the line into political campaign intervention.<sup>75</sup> In 2013, the IRS issued proposed regulations with the intent to make it clearer when such lines are crossed in the social welfare organization context.<sup>76</sup> But, in Consolidated Appropriations Acts since 2016 Congress has blocked the IRS from implementing rules to clarify this space. In the Consolidated Appropriations Act of 2022, for example, Congress prohibited the IRS and the Treasury Department from issuing rules about section 501(c)(4) organizations.<sup>77</sup> It fixes the status of the law regarding these organizations with the “standard and definitions as in effect on January 1, 2010, which are used to make such determinations . . . for purposes of determining status under section 501(c)(4) of such Code of organizations created on, before, or after” the Act.<sup>78</sup>

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<sup>73</sup> See, e.g., Letter 202216018 <https://www.irs.gov/pub/irs-wd/202216018.pdf> (emphasis added).

<sup>74</sup> See Ellen P. Aprill, *Examining the Landscape of Section 501(c)(4) Social Welfare Organizations*, 21 N.Y.U. J. LEGIS. & PUB. POL’Y 345, 346-47 (2018) (noting that some practitioners take this position); see also JAMES FISHMAN, STEPHEN SCHWARZ & LLOYD MAYER, *NONPROFIT ORGANIZATIONS* 496 (5<sup>th</sup> Ed. 2015) (noting that the question is a facts and circumstances test but that many practitioners take the position that as long as the organization does less than fifty percent non-social welfare purpose activity it should still qualify). The IRS in 2013 after the Tea Party controversy created Letter 5228. In it, the IRS adopted a safe harbor of a sort for a certain set of organizations where it used a 60% threshold. The IRS would approve an application of an organization that could represent it would spend 40% or less in time and expenditures on “on direct or indirect participation or intervention in any political campaign.” I.R.S. LETTER 5228 (Rev. 9-2013) <https://www.irs.gov/pub/irs-tege/letter5228.pdf>.

<sup>75</sup> The IRS consideration of the application for exemption of the major political social welfare organization associated with Karl Rove, Crossroads GPS is a good example. Though the IRS initially proposed denying social welfare status to the organization because many of the ads it ran appeared to be political campaign intervention, the IRS Appeals Office granted the organization status after Crossroads filed an appeal with the IRS Appeals Office. See Robert Maguire, *How Crossroads GPS beat the IRS and Became a Social Welfare Group*, OPEN SECRETS (February 12, 2016) <https://www.opensecrets.org/news/2016/02/how-crossroads-gps-beat-the-irs-and-became-a-social-welfare-group/>.

<sup>76</sup> Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities, (REG-134417-13) 78 FR 71535-01, 2013-52 I.R.B. 856, (November 29, 2013).

<sup>77</sup> H.R. 2471, Div E, Title I, sec. 123 (2022) <https://rules.house.gov/sites/democrats.rules.house.gov/files/BILLS-117HR2471SA-RCP-117-35.pdf>.

<sup>78</sup> *Id.*

Like charities, a social welfare organization cannot allow its earnings to inure to the benefit of a private shareholder or individual.<sup>79</sup> Additionally, the private benefit limitation discussed with regard to charities in Part II(b), and the tax under section 4958 on excess benefit transactions applies to social welfare organizations like described above with respect to charities.<sup>80</sup>

After legislation in 2015, any organization that intends to operate as a social welfare organization must provide notice to the IRS of its intention within 60 days of its formation.<sup>81</sup> The organization files a Form 8976 to meet this notice requirement. Social welfare organizations must file a Form 990 just like a charity.<sup>82</sup> I will discuss this requirement more below in Part II(d).

## ii. *Business leagues*

Business leagues present many of the same issues as do social welfare organizations. They are exempted from the income tax under section 501(c)(6) and include “[b]usiness leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues.”<sup>83</sup> A business league must promote a common business interest and direct its activities towards the improvement of business conditions in one or more lines of business as distinguished from the performance of particular services for individual persons.<sup>84</sup> These organizations broadly support various industries or professions through education, advertising, networking, lobbying.<sup>85</sup> Similarly to social welfare organizations, a business league is prohibited from allowing its earnings to inure to a private shareholder or individual. Though the term is not expressly used in the Treasury Regulations or the Code, it is understood that a business league must primarily operate for its exempt purpose.<sup>86</sup>

As with social welfare organizations, lobbying is a permissible purpose of a business league.<sup>87</sup> The Office of the Chief Counsel has determined that political campaign intervention does not further a business league purpose.<sup>88</sup> The practical

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<sup>79</sup> 26 U.S.C. § 501(c)(4).

<sup>80</sup> 26 U.S.C. § 4958(e) (applicable tax-exempt organization includes “any organization which . . . would be described in paragraph (3), (4), or (29) of section 501(c) and exempt from tax under section 501(a)”).

<sup>81</sup> 26 U.S.C. § 506.

<sup>82</sup> 26 U.S.C. § 6033.

<sup>83</sup> 26 U.S.C. 501(c)(6).

<sup>84</sup> Treas. Reg. § 1.501(c)(6)–1.

<sup>85</sup> For a detailed discussion of the activities and types of business leagues, see Philip Hackney, *Taxing the Unheavenly Chorus: Why Section 501(c)(6) Trade Associations are Undeserving of Tax Exemption*, 92 DEN. U. L. REV. 265 (2015).

<sup>86</sup> See, e.g., *American Auto Ass’n v. Comm’r*, 19 T.C. 1146, 1159 (1953) (“petitioner was *primarily* a service organization. Its Principal activities, as disclosed by our findings of fact, consisted of performing particular services, and securing benefits of a commercial nature for its members) (emphasis added); see also, John Francis Reilly, Carter Hull, & Barbara Allen, *IRC 501(c)(6) Organizations*, I.R.S. EO CPE Text, K-20 (2003) <https://www.irs.gov/pub/irs-tege/eotopick03.pdf> (“the activities of the organization cannot be primarily directed to the performance of particular services for individual persons”).

<sup>87</sup> Rev. Rul. 61–177, 1961–2 C.B. 117.

<sup>88</sup> See I.R.S. Gen. Couns. Mem. 34,233 (Dec. 3, 1969). Campaign finance law also significantly impacts the operation of business leagues in the political campaign sphere. For instance, a business league, as a

result of this regime is that business leagues can do unlimited lobbying, assuming it furthers the organization's purpose, and can under tax law intervene in a political campaign as long as that is not the business league's primary purpose.<sup>89</sup>

#### d. Information Reporting Requirements

Most organizations exempt from income tax under section 501(a) of the Code must file an annual information return "stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the internal revenue laws."<sup>90</sup> This is the Form 990, the annual information return for IRS tax purposes.<sup>91</sup> The return both serves a means of ensuring the organization complies with its tax status, by providing information that could allow the IRS to detect if there is any avoidance of tax and provides the public information to hold these organizations publicly accountable.

The Form 990 is generally available to the public pursuant to the Code,<sup>92</sup> and has been publicly accessible since 1950.<sup>93</sup> The public disclosure of the returns arguably brings "some measure of organizational accountability to various constituencies, including current and prospective donors, organization employees and patrons, other exempt entities, and the citizenry at large."<sup>94</sup> The Joint Committee on Taxation has suggested "[d]isclosure of information regarding tax-exempt organizations also allows the public to determine whether the organizations should be supported - either through continued tax benefits and contributions of donors - and whether changes in the laws regarding such organizations are needed."<sup>95</sup> The Independent Sector suggests the unique role of nonprofits in our society as *voluntary organizations* requires more public disclosure.<sup>96</sup>

Up until recently, most exempt organizations were required to disclose to the IRS, but not the public, the substantial donors to the organization during the taxable

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corporation, is subject to the law that they use "separate segregated funds" as controlled political action committees to make contributions to candidates for federal political campaigns. 52 U.S.C. 30118; 11 C.F.R. §§ 114.1(a)(2)(iii) & 114.5.

<sup>89</sup> Inspector Gen. for Tax Admin., *Review of the Processing of Referrals Alleging Impermissible Political Activity by Tax-Exempt Organizations*, Ref. Num. 2019-10-006, 3 (Oct. 4, 2018).

<sup>90</sup> 26 U.S.C. § 6033.

<sup>91</sup> I.R.S., FORM 990, RETURN OF EXEMPT ORGANIZATION EXEMPT FROM INCOME TAX

<https://www.irs.gov/pub/irs-pdf/f990.pdf>. The IRS and the Treasury Department enacted a regulation in 1942 requiring tax-exempt organizations to file a Form 990 for tax years beginning in 1941. T.D. 5125 (IRS TD), 1942-1 C.B. 101, 1942. Congress followed that regulation up in 1944 with a requirement for a tax information return for certain tax-exempt organizations. The Revenue Act of 1943, Pub. L. No. 78-235, 58 Stat. 28 implementing then § 54.

<sup>92</sup> 26 U.S.C. § 6104(b).

<sup>93</sup> Revenue Act of 1950, H.R. 8920, 81st Cong. §341 (1950).

<sup>94</sup> Caroline K. Craig, *The Internet Brings 'Cyber-Accountability' to the Nonprofit Sector*, 13 J. TAX'N EX. ORG. 82 (2001).

<sup>95</sup> Staff of the Joint Comm. on Taxation, 106th Cong., STUDY OF DISCLOSURE PROVISIONS RELATING TO TAX-EXEMPT ORGANIZATIONS, at 5 (2000); see also Lloyd Hitoshi Mayer, *The Promises and Perils of Using Big Data to Regulate Nonprofits*, 94 WASH. L. REV. 1281, 1297-98 (2019).

<sup>96</sup> Evelyn Brody, *Sunshine and Shadows on Charity Governance: Public Disclosure as a Regulatory Tool*, 12 FLA. TAX REV. 183, 212 (2012).



year.<sup>97</sup> That requirement to disclose substantial donors was required in the first Form 990 for the 1941 tax year.<sup>98</sup> Congress later statutorily required this donor information from charitable organizations in the 1969 Tax Act.<sup>99</sup> Today, the information is collected on Schedule B to the Form 990 and requires the disclosure of substantial donors generally meaning those who donated the greater of \$5,000 or 2% of total donations to the nonprofit during the year.<sup>100</sup> Congress prohibits the public disclosure of the names and addresses of contributors of all but private foundations and political organizations.<sup>101</sup> Though the Treasury Department and IRS long required other exempt organizations to disclose this information via regulation and the Form 990, in 2020, the Treasury Department and the IRS finalized regulations ending that requirement for all but charitable organizations.<sup>102</sup>

The ending of the collection of this information was a mistake on the part of the IRS. The IRS needs the information regarding substantial donors from not just charitable organizations, but also the dark money organizations in order to protect the revenue and as a means to deter tax avoidance. The ending of the collection of that information also likely impacts the integrity of the campaign finance system as individuals can contribute to social welfare organizations with the knowledge that there is no information going to any part of the government regarding these contributions.

To police the inurement provision, the IRS needs to know substantial contributors because these are individuals who can control the organization.<sup>103</sup> The IRS has no reliable way to know this information without the exempt organization directly disclosing it to the IRS. Substantial donors are not public facing in the way officers and directors of a nonprofit corporation are public facing. The same goes for enforcing the excess benefit transaction tax imposed for charities and social welfare organizations. The IRS needs to know the individuals who control the organization and substantial

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<sup>97</sup> I.R.S., FORM 990, RETURN OF ORGANIZATION EXEMPT FROM TAX, <https://www.irs.gov/pub/irs-pdf/f990.pdf>.

<sup>98</sup> See Form 990 EO CPE Text describing how the 1941 Form 990 required disclosure of substantial donors (those donating \$4,000 or more) Form 990. Done initially in 1943 to develop the information needed to determine whether the organizations at hand ought to be exempt from taxation. See Senate Finance Committee Report in the Revenue Bill of 1943, p. 21. <https://www.finance.senate.gov/imo/media/doc/SRpt78-627.pdf> The Revenue Act of 1943 was not enacted until February 1944 because of a Presidential Veto. <https://www.loc.gov/law/help/statutes-at-large/78th-congress/session-2/c78s2ch63.pdf> Pub. L. No. 235, 78th Cong., 2d Sess. (Feb. 25, 1944).

<sup>99</sup> Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487.

<sup>100</sup> Schedule B, Form 990, <https://www.irs.gov/pub/irs-pdf/f990ezb.pdf>.

<sup>101</sup> 26 U.S.C. § 6104(b).

<sup>102</sup> Guidance Under Section 6033 Regarding the Reporting Requirements of Exempt Organizations, 85 Fed. Reg. 31959 (May 28, 2020) (codified at 26 CFR 56) T.D. 9898.

<sup>103</sup> The Supreme Court recently struck down as facially unconstitutional under the First Amendment a state law in California requiring charities soliciting donations in the state of California to disclose substantial donors identified on Schedule B to the IRS Form 990. *Americans for Prosperity Foundation v. Bonta*, 141 S.Ct. 2373 (2021). I submitted an amicus brief in *Americans for Prosperity* along with eleven other nonprofit scholars supporting the state of California in its effort to protect its ability to require this donor information from charities. Brief of Amici Curiae Scholars of the Law of Non-Profit Organizations in Support of Respondent, *Americans for Prosperity Foundation v. Bonta*, 141 S.Ct. 2373 (2021) (Nos. 19-251 & 19-255). The Court was careful to note that its opinion applied to neither campaign finance nor to tax law. *Id.* at 2389.

contributors fall into this category.<sup>104</sup> The IRS cannot truly enforce this tax Congress imposed without the information. Substantial contributor information can aid the IRS in enforcing the private benefit limitation as well. Finally, if the IRS wants to keep track of related dark money organizations that might try to avoid the primarily test by working in tandem to maximize the amount of money they can use to engage in political campaign intervention, Schedule B can provide essential information to see such relationships.<sup>105</sup>

Requiring disclosure to the IRS acts as a deterrent to tax avoidance as well.<sup>106</sup> The Treasury Department notes that tax noncompliance is highest where there is no third-party reporting.<sup>107</sup> The Treasury Department highlights the need to “strengthen reporting requirements,”<sup>108</sup> and notes that enforcement activity itself is not a driver of reducing the tax gap.<sup>109</sup> In its 2001 study, the IRS found that about 45% of compliance has to do with information reporting.<sup>110</sup> Given the significant lack of enforcement of the tax laws from the IRS as discussed below in Part III, ending this requirement to disclose substantial donors becomes even more damaging.

The tax law in the exempt organization space works in part as a back-up to campaign finance law. In addition to tax law, Congress regulates many nonprofit organizations to the extent they are engaged in campaign finance.<sup>111</sup> Nonprofits have long been involved in the electoral system,<sup>112</sup> and the United States has tried to regulate the campaign finance of corporate entities since 1907 when Congress enacted the Tillman Act under President Theodore Roosevelt.<sup>113</sup> This system of law focuses on expenditure limits, contribution limits, and disclosure. Though a series of cases over the years has struck down certain parts of the system enacted by Congress, it remains in

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<sup>104</sup> 26 U.S.C. § 4958(c)(3)(B)(i) (including “substantial contributor” in the group of individuals who can violate the excess benefit transaction tax).

<sup>105</sup> The idea here is a donor could contribute \$1 million to a social welfare organization. That first social welfare organization could spend 49% on political campaign intervention and send 50% of the money to another social welfare organization. That second organization does the same thing. Via this strategy, the organization theoretically is accomplishing social welfare organization purposes through contributing to another social welfare organization but is indeed almost exclusively accomplishing political campaign activity. It is hard to see how such a scheme could be considered to qualify under section 501(c)(4), but without the donor information on Schedule B it should be much more difficult for the IRS to detect such transactions. Schedule I to the Form 990 helps in part but the Schedule B combined with the Schedule I would enable the IRS to see such transactions quicker and more reliably.

<sup>106</sup> See *Dark Money Darker*, *supra* note 1, at 170-75.

<sup>107</sup> See OFFICE OF TAX POLICY, U.S. DEP'T OF TREASURY, A COMPREHENSIVE STRATEGY FOR REDUCING THE TAX GAP 8 (2006), available at [https://www.irs.gov/pub/irs-news/comprehensive\\_strategy.pdf](https://www.irs.gov/pub/irs-news/comprehensive_strategy.pdf).

<sup>108</sup> *Id.* at 9.

<sup>109</sup> *Id.* at 13.

<sup>110</sup> See I.R.S., Tax Year 2001 Tax Gap Update 2 (2007); see also Leandra Lederman, *Essay: Reducing Information Gaps to Reduce the Tax Gap: When is Information Reporting Warranted?*, 78 FORDHAM L. REV. 1733, 1738 (2010).

<sup>111</sup> Federal Election Campaign Act of 1971, Pub. L. No. 92-225, 86 Stat. 3 (codified as amended at 2 U.S.C. §§ 431-455).

<sup>112</sup> Lloyd Hitoshi Mayer, *When Soft Law Meets Hard Politics: Taming the Wild West of Nonprofit Political Involvement*, 45 J. LEGIS. 194, 196 (2019).

<sup>113</sup> Ch. 420, 34 Stat. 864 (1907). See *Federal Election Commission v. Beaumont*, 539 U.S. 146 (2003) (holding that the corporate political contribution ban applied to nonprofit corporations).

force today.<sup>114</sup> Knowledge of donors to nonprofits is relevant to the enforcement of that law. For instance, the system prohibits foreign actors from contributing to campaigns for public office or making expenditures for political campaigns.<sup>115</sup> To the extent a social welfare organization takes money from foreign operators to influence a campaign, the FEC cares. Some argue indeed that the lack of public disclosure of substantial donors to social welfare organizations is making nonprofits a disclosure shelter, and thereby undermining the nonprofit sector's credibility.<sup>116</sup>

The IRS in its final regulations eliminating the disclosure requirement suggested that neither campaign finance nor state nonprofit law was part of its mission. It argued, thus, that it need not consider comments suggesting that it was important for the IRS to maintain the requirement to help states enforce nonprofit law and campaign finance laws. I have argued that the IRS was wrong that it need not take other law into consideration. Congress has designed the tax law to work in tandem with other enforcement agencies both federal and state and local.<sup>117</sup>

What penalties does the IRS have at hand to manage failures to file Form 990s or false information on Form 990s?

Section 6652 penalizes either a failure to file an information return or to file a complete return.<sup>118</sup> The penalty on the organization is \$20 a day with a maximum for smaller organizations of \$10,000 and of larger organizations at \$50,000.<sup>119</sup> The IRS has stated that a return that leaves out material information is an incomplete return that can be penalized.<sup>120</sup> The IRS has suggested that "materiality depends upon what the Service requires to administer the tax laws."<sup>121</sup> Additionally there are criminal penalties, such section 7206 which applies when someone "[w]illfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter."<sup>122</sup> These criminal charges require a high burden of proof and are not often used by the IRS except typically in egregious cases.

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<sup>114</sup> *Citizens United v. FEC*, 558 U.S. 310 (2010); *SpeechNow.org v. FEC*, 599 F.3d 686 (D.C. Cir. 2010) (en banc), cert. denied, 562 U.S. 1003 (2010)

<sup>115</sup> 52 U.S.C. §30121; 11 C.F.R. § 110.20. See Norman I. Silber, *Foreign Corruption of the Political Process through Social Welfare Organizations*, 114 NW. U. L. REV. ONLINE 104 (2019).

<sup>116</sup> Roger Colinviaux, *Social Welfare and Political Organizations: Ending the Plague of Inconsistency*, 21 N.Y.U. J. LEGIS. & PUB. POL'Y 481 (2018).

<sup>117</sup> For example, Congress enhanced 26 U.S.C. § 527 in 2000 to augment the FEC's roll in overseeing campaign finance by creating an IRS reporting regime for those political organizations that did not need to file reports with the FEC. Congress directs the IRS to work with state agencies as they revoke exemption from charitable organizations in 26 U.S.C § 6104. As a practical matter the IRS works regularly with other agencies such as the Federal Bureau of Investigation, the Department of Justice, the Federal Communications Commission, the Department of Labor to ensure that the federal laws are enforced.

<sup>118</sup> 26 U.S.C. § 6652(c).

<sup>119</sup> *Id.*

<sup>120</sup> I.R.S. Office of Chief Counsel, PMTA 01357, Memorandum from James Brokaw to David Fish, Nov. 2, 2007. [https://www.irs.gov/pub/lanoa/pmta01357\\_7359.pdf](https://www.irs.gov/pub/lanoa/pmta01357_7359.pdf). Rev. Rul. 77-162.

<sup>121</sup> *Id.*

<sup>122</sup> 26 U.S.C. 7206.

### III. IRS Enforcement

What resources does the IRS have at its disposal to ensure taxpayers are complying with the law? A review of the trend over the past 10 years suggests the IRS does not have the resources, human or capital, needed to enforce the current tax law.<sup>123</sup> Furthermore, the IRS places low budget priority on the exempt organization sector likely because it delivers little in tax revenue.<sup>124</sup>

While the economy grew, Congress shrunk the IRS budget over the past decade. The Congressional Budget Office (“CBO”) reports that the IRS budget fell by 20% in real (inflation adjusted) dollars between 2010 and 2018.<sup>125</sup> This resulted in a 22% decrease in employees working at the agency, and a 30% decline in enforcement employees.<sup>126</sup> IRS Data Books show the IRS went from over 94,000 full time equivalent (“FTEs”) employees in FY 2010 to 73,554 FTEs in FY 2019.<sup>127</sup> Furthermore, some of the most specialized employees in the enforcement sphere saw declines of 35% for revenue agents and 48% for revenue officers.<sup>128</sup> Individual examinations fell by 46% in that period with only 0.6% of individuals facing an examination by the end of that period.<sup>129</sup> While high income individuals were generally audited at a rate higher than other individuals, the audits of high-income individuals fell at a greater rate than all other individuals.<sup>130</sup> Corporate examinations fell by 37%.<sup>131</sup>

What happened to the IRS in its tax-exempt organization group? The Government Accountability Office (“GAO”) in 2014 recognized that the budget cuts at the IRS led to less enforcement in the tax-exempt sector.<sup>132</sup> The IRS workforce on exempt organization matters shrank about 5% from 2010 (889 FTEs) to 2013 (842 FTEs).<sup>133</sup> That workforce then shrank significantly to around 550 FTEs by FY 2019.<sup>134</sup> There was a change in the exempt organizations group at the IRS after the Tea Party controversy of 2013<sup>135</sup> where many employees of exempt organizations moved over to

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<sup>123</sup> See, e.g., Paul Keil & Jesse Eisinger, *How the IRS was Guttled*, PROPUBLICA (Dec. 11, 2018). See also Leandra Lederman, *The IRS, Politics, and Income Inequality*, TAX NOTES, 1329 (March 14, 2016).

<sup>124</sup> Much of this Part II(d) comes from *Dark Money Darker*, *supra* note 1, at 175-79.

<sup>125</sup> CONGRESSIONAL BUDGET OFFICE, TRENDS IN THE INTERNAL REVENUE SERVICE’S FUNDING AND ENFORCEMENT, 1 (2020).

<sup>126</sup> *Id.*

<sup>127</sup> INTERNAL REVENUE SERVICE, DATA BOOK, 74 Table 31 (2019); INTERNAL REVENUE SERVICE, DATA BOOK, 66 Table 29 (2010).

<sup>128</sup> *Id.*

<sup>129</sup> *Id.* at 2.

<sup>130</sup> *Id.*

<sup>131</sup> *Id.*

<sup>132</sup> GAO, BETTER COMPLIANCE INDICATORS AND DATA, AND MORE COLLABORATION WITH STATE REGULATORS WOULD STRENGTHEN OVERSIGHT OF CHARITABLE ORGANIZATIONS, 19 (2014).

<sup>133</sup> *Id.*

<sup>134</sup> IRS, TEGE, FISCAL YEAR 2019 ACCOMPLISHMENTS, Pub. 5329 (2020).

<sup>135</sup> For more on this matter see Philip T. Hackney, *Should the IRS Never ‘Target’ Taxpayers? A Consideration of the IRS Tea Party Affair*, 49 VAL. L. REV. 453 (2015). The Treasury Inspector General for Tax Administration (TIGTA) later concluded that the IRS treated both conservative and liberal groups in the same way in the IRS determination process. Inspector Gen. for Tax Admin., *Review of Selected Criteria Used to Identify Tax-Exempt Applications for Review*, Ref. Num. 2017-10-054 (September 28, 2017) <https://www.treasury.gov/tigta/auditreports/2017reports/201710054fr.pdf>. The Senate Finance

the Chief Counsel to manage guidance projects from that office. In 2014, it was reported that around forty-five employees from the IRS were being moved over to the Office of Chief Counsel of the IRS in a realignment.<sup>136</sup> However, even if forty-five moved over, that does not explain the precipitous drop.

The main functions of the exempt organizations group are running an application system called the determinations process, and an examination program. In determinations, as annual applications have increased annual rejections from the IRS have significantly decreased.<sup>137</sup> In FY 2019, the IRS reviewed over 101,000 applications for exempt status, it rejected only 66 of those applications.<sup>138</sup> Comparatively, in FY 2010, the IRS reviewed over 65,000 of such applications and rejected 517.<sup>139</sup> Admittedly, a large number of applicants withdraw their applications before denial and this statistic has the potential to be misleading. When looking at examinations, it is impossible to have a perfect figure given the way the data is reported in the IRS Data Book, but of all the returns filed and all the returns examined in 2010, which likely includes some double counting of organizations (and includes sizable employment tax returns), the IRS had about a .38% examination rate.<sup>140</sup> In 2019, comparatively, even with the double counting problem, the examination rate shrinks to 0.15% at best.<sup>141</sup> TIGTA counted the rate in 2019 at 0.13%.<sup>142</sup>

This erosion of the IRS workforce and enforcement happened while the tax-exempt sector grew. Though a comparison of IRS data between 2010 and 2019 seems to suggest that total tax-exempt organizations shrunk,<sup>143</sup> the sector has grown in size of assets. It is difficult to get good current statistics on nonprofits. There are many problems with the data from the IRS including the fact that not all organizations file returns<sup>144</sup> or do not file returns that provide any significant data,<sup>145</sup> and we have no reason to believe all organizations file their returns accurately. Nevertheless, a look at IRS data from Forms 990 suggests assets and revenue have increased quite a bit in the

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Committee's Bipartisan Investigative Report concluded similarly in 2015. SENATE FINANCE COMMITTEE, THE I.R.S.'S PROCESSING OF 501(C)(3) AND 501(C)(4) APPLICATIONS FOR TAX-EXEMPT STATUS SUBMITTED BY "POLITICAL ADVOCACY ORGANIZATIONS FROM 2010-2013, Sen. Rep. 114-119 (August 5, 2015)

<https://www.congress.gov/congressional-report/114th-congress/senate-report/119/1>

<sup>136</sup> Diane Freda, *Move of 45 IRS TE/GE Employees to Chief Counsel's Office Slated for FY 2015*, BLOOMBERG LAW NEWS (May 14, 2014). Some of those forty-five came from employee plans. One article from the time suggests it was only twenty-two employees from the exempt organizations group that moved over. Lauren Simpson, *IRS Controversy and Restructuring*, NONPROFIT LAW BLOG (May 29, 2014) <https://www.pbwt.com/exempt-org-resource-blog/nonprofit-law-blogirs-controversy-changes-tege>.

<sup>137</sup> Philip Hackney, *The Real IRS Scandal has more to do with Budget Cuts than Bias*, THE CONVERSATION (April 15, 2018).

<sup>138</sup> IRS, DATA BOOK, 27, Table 12 (2019).

<sup>139</sup> IRS, DATA BOOK, 56, Table 24 (2010).

<sup>140</sup> IRS, DATA BOOK, 4, Table 2, 33, Table 13 (2010).

<sup>141</sup> IRS, DATA BOOK, 4, Table 2, & 54 Table 21 (2019).

<sup>142</sup> Inspector Gen. for Tax Admin., *Obstacles Exist in Detecting Noncompliance of Tax-Exempt Organizations*, Ref. No. 2921-10-013, 6 (2021).

<sup>143</sup> IRS, DATA BOOK, 56, Table 25 (2010); IRS, DATA BOOK, 30 Table 14 (2019).

<sup>144</sup> After Congress added 26 U.S.C. § 6033(h) to the Code in 2006, and the IRS implemented what it calls the Form 990-N (e-Postcard), churches are likely far and away the largest group of charities that file no IRS return.

<sup>145</sup> Form 990-N provides little in the way of information regarding the organization.



sector over the decade.<sup>146</sup> In 2010, with a little over 186,000 charitable organization Form 990s filed, the charitable sector held over \$2.9 trillion in assets and almost \$1.6 trillion in revenue.<sup>147</sup> In comparison, in 2017 over 217,000 charitable organizations filed Form 990s reporting over \$4.3 trillion in assets and almost \$2.3 trillion in revenue.<sup>148</sup> Using that same data, again from reporting on Forms 990, for exempt organizations including 501(c)(4)-(9) in 2010 there were approximately \$547 billion in assets and \$360 billion in revenue.<sup>149</sup> In 2017, those amounts grew to approximately \$767 billion in assets and \$387 billion in revenue.<sup>150</sup>

Thus, the enforcement environment for the IRS is poor both at the IRS in general and at the division that oversees tax-exempt organizations in particular. When compared to the size of the sector the IRS is reviewing, the idea that the IRS might be able to use human resource heavy examinations to ensure compliance is laughable. It is not going to work. Though I will not go into this here, state enforcement is even more anemic. Efforts, such as those recommended by GAO, for the IRS to make better use of data available is going to be the only way the IRS in this current environment can make headway against tax abuse. Robust information reporting thus needs to be the norm.

As noted above, the IRS often has given short shrift to the tax-exempt organization enforcement side of its house. This is likely in part because the sector simply does not generate revenue, and it comes with enforcement that has potential political danger if not handled with care. Nevertheless, it seems possible and important for the IRS to do more in this space with publicly available campaign spending reports filed with the FEC. Many cases noted by Citizens for Responsibility and Ethics in Washington where social welfare organizations represent one thing to the FEC regarding making independent expenditures and then reporting nothing to the IRS on the Form 990 are troubling. Such cases seem to present *prima facie* cases of substantial political campaign intervention that at the least ought to be investigated. They also present questionable statements on Form 990s.

#### **IV. Conclusion**

Thank you for inviting me to speak about the laws and enforcement governing the political activities of tax-exempt organizations. The tax laws are built fairly well to prohibit the deduction of campaign expenditures and to promote a strong nonprofit sector. There are problems with that architecture. For instance, Congress could consider requiring donors to recognize gain on the contribution of appreciated assets to a dark money organization. This would end an indirect means of deducting political activity. Additionally, it would help if the IRS were permitted to issue rules clarifying the boundaries of political campaign activity for social welfare organizations. However, the legal architecture works reasonably well in theory to ensure the government is not

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<sup>146</sup> IRS, SOI Tax Stats—Charities & Other Tax-Exempt Organization Tax Statistics, Form 990—Balance Sheet and Income Statement Items.

<sup>147</sup> *Id.* 2010.

<sup>148</sup> *Id.* 2017.

<sup>149</sup> *Id.*

<sup>150</sup> *Id.*

subsidizing campaign-related contributions through the Code and to ensure a well-ordered nonprofit sector. That said, the current anemic IRS budget, the lack of enforcement action by the IRS, and the failure to collect substantial donor information from dark money organizations creates a crisis. There is good reason to believe that taxpayers are able to take advantage, and indeed are taking advantage, of this system. These factors undermine confidence in the tax system, the equal enforcement of the law, and our ability to operate a fair democratic system. Therefore, I urge Congress to increase the IRS budget to a level that allows the IRS the ability to properly enforce the tax laws. But, institutionally, I believe the IRS needs to be pushed and given support to enforce these laws that help work toward a more fair democratic order.