# Committee on Ways and Means
# United States House of Representatives

Comments of

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and

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APMA Legal & Educational Foundation
Bruce W. Eberle & Associates, Inc.
Citizens Against Government Waste
Citizens United
Coalition to Stop Gun Violence
English First
Freedom Alliance
Gun Owners of America
High Frontier
The Leadership Institute
National Center for Cardiac Information
National Rifle Association
National Right to Life Committee
Policy Analysis Center
Public Advocate
60 Plus Association
Squire & Heartfield Direct, Inc.
Tri-State Envelope Corporation
United Seniors Association, Inc.
United States Border Control
U. S. Taxpayers Alliance

With respect to the
Study of Disclosure Provisions
Relating to Tax-Exempt Organizations
Produced by the
Joint Committee on Taxation
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## INTRODUCTION

The Free Speech Coalition, Inc. is pleased to submit these comments along with other organizations and companies with respect to the Joint Committee on Taxation's Study of Disclosure Provisions Relating to Tax-Exempt Organizations. This study comprises the second volume of a three-volume Study of Present-Law Taxpayer Confidentiality and Disclosure Provisions which was published on January 28, 2000, pursuant to Section 3802 of the IRS Restructuring and Reform Act of 1998.

The Free Speech Coalition, Inc. ("FSC"), founded in 1993, is a nonpartisan group of ideologically diverse nonprofit organizations and the for-profit organizations which help them raise funds and implement programs. Our purpose is to protect First Amendment rights through the reduction or elimination of excessive regulatory burdens which have been placed on the exercise of those rights.

FSC is joined in these comments by several concerned tax-exempt organizations and for-profit companies, including: Accuracy in Media; American Center for Law and Justice; American Conservative Union; American Preventive Medical Association; American Target Advertising, Inc.; APMA Legal & Educational Foundation; Bruce W. Eberle & Associates; Citizens Against Government Waste; Citizens United; Coalition to Stop Gun Violence; English First; Freedom Alliance; Gun Owners of America; High Frontier; The Leadership Institute; National Center for Cardiac Information; National Rifle Association; National Right to Life Committee; Policy Analysis Center; Public Advocate; 60 Plus Association; Squire & Heartfield Direct, Inc.; Tri-State Envelope Corporation; United Seniors Association, Inc.; United States Border Control; and U. S. Taxpayers Alliance.

## SUMMARY

FSC and its co-commenters fully support efforts to ensure accountability within the nonprofit community, and reasonable oversight of that community by the Internal Revenue Service. While the road to the Joint Committee's study may have been paved with good intentions, several of the study's recommendations are badly flawed. Indeed, it is difficult to conclude that certain of the important matters dealt with in the study were truly "studied."

Specifically, we are concerned that, in trying to ensure the provision of more complete information regarding tax-exempt organizations to the general public, enactment of the study's findings would instead inhibit the orderly resolution of audits, guarantee the diversion of charitable assets from tax-exempt purposes to legal defense purposes, and facilitate greater opportunity for IRS abuse of its oversight authority through the publication — and transmission to state authorities — of interim (read unbalanced and incomplete) findings and analyses in the determination and audit process.

To its credit, the study acknowledges the existence of a tension between tax-exempt organizations' right to privacy, arising in part out of their concern about misuse of private information, and the study's purported principal objective — the public's right to know.

Curiously, there is no indication that the general public has even the slightest interest in the additional information proposed to be compelled to be released at substantial expense under the study's recommendations. Even the provision in the statute (Section 3802) which called for the staff study was in neither the House nor Senate bill, arising spontaneously in the conference committee's version – probably at the urging of regulators seeking greater power over the independent sector of the economy. Yet the study finds that "information regarding tax-exempt organizations … should be disclosed unless there are compelling reasons for nondisclosure that clearly outweigh the public interest in disclosure." (Vol. II, pp. 6, 80-81.)

FSC and its co-commenters urge the Committee to consider alternatives to proposing new legislation. If, however, it deems new federal legislation appropriate, such legislation should focus more on scrutinizing the enforcement activities of the IRS, thereby reducing the Service's vulnerability to charges of abuse in its exercise of authority over the nonprofit community.

## COMMENTS

### 1. Requiring the disclosure of more documents relating to audits and closing agreements will reduce the chance of anything being resolved short of litigation.

Audits of tax-exempt organizations are perceived within the nonprofit community as designed to ensure compliance with applicable law, and to obtain effective corrective action where necessary. Closing agreements have been the principal vehicle that the IRS has used over the past decade to resolve cases and obtain compliance by tax-exempt organizations.

Currently, tax-exempt organizations have strong incentives to resolve an audit as quickly and painlessly as possible. While such incentives do not preclude occasional gamesmanship, or strategic withholding of information, they certainly promote prompt and complete responses to appropriate requests. Further, if a closing agreement would not be made public, counsel for the tax-exempt organization may be far more likely to accept an admission of liability on an issue that is questionable (or capable of being litigated effectively).

By contrast, the prospect that documents will be publicly released, as the study recommends, would lead to posturing by both sides, substantially diminishing the likelihood of settlement. Negotiations would be conducted as if everything will be reported in the newspaper. The exempt organization's counsel will seek to assess how each document could

be "spun" for greatest journalistic (or, as regards information provided by the IRS to state attorneys general, greatest political) impact.

The study observed, speciously we would submit, that:

> There are a variety of reasons why both the IRS and a tax-exempt organization may wish to settle a matter that are independent of whether the activity will be disclosed. These include the costs of litigation, as well as the likelihood of ultimate success on the merits. Further, if a tax-exempt organization chooses not to settle a matter, the only option will be litigation, which also will result in public disclosure. With respect to the effect of disclosure on voluntary compliance, the Joint Committee staff notes that it would be inconsistent with an organization's exempt purposes and fiduciary responsibilities to continue to engage in activity that violates the law. Thus, tax-exempt organizations should continue to have an interest in voluntary compliance and correction of inappropriate activity regardless of whether such activity is disclosed publicly. [Vol. II, p. 86.]

However, the Joint Committee staff's analysis lacks mature consideration of several points. To begin with, speaking bluntly, the IRS' assertion of a finding does not make it true. Further, the IRS has been known to experiment with aggressive, untested legal theories upon unsuspecting tax-exempt organizations, based on iterations of their famous "facts and circumstances" test, which at least one federal appeals court has called "no standard at all." United Cancer Council, Inc. v. Commissioner of Internal Revenue, 165 F.3d 1173 (7th Cir., 1999).

As noted above, under current law, with a private agreement, the balancing of costs between paying the penalties of the settlement and those incurred by litigating the issues, with consideration of the likelihood of ultimate success, may lead an organization to prefer settlement over defense of its rights in court — even where such a defense would likely prove successful. On the other hand, if the nonprofit's donors are likely to hear of the organization's essentially false admission, the cost becomes far higher. The study simply does not deal with that truth.

Further, while public disclosure may occur pursuant to litigation, such disclosure — *e.g.*, the IRS alleges that the nonprofit has engaged in X practice, but the nonprofit denies the allegation and is fighting the IRS in court — lacks the impact of a public admission of impropriety. Thus, it would normally be in the tax-exempt organization's best interests to defend its innocence, when the only recourse would be public disclosure of admitted tax violations.

Likewise, the Joint Committee staff's assertion that a nonprofit should cease any activity that the IRS does not favor, on the IRS' word alone, presumes a deference that the IRS has not earned.

Clearly, one likely consequence of the enactment of the study's findings would be that most disputes will wind up in court — thereby increasing the cost of handling audits for both exempt organizations and the IRS. Given the current environment of limited resources dedicated to exempt organization oversight, the study's proposals (issued with the intent of facilitating greater oversight of tax-exempt organizations) may logically result in fewer audits and less oversight.

While the Joint Committee staff proffered its proposals with the justification that "public oversight of tax-exempt organizations generally is viewed as increasing compliance with Federal and State laws" (*id.*, p. 65), it is far from self-evident that these proposals would result in improved public oversight of tax-exempt organizations. As the study itself acknowledged:

> Some argue that increased disclosure will not result in an increase in the quality and quantity of information received. It has been suggested that tax-exempt organizations may attempt to manipulate publicly available information so that the public perceives the information in a more favorable way, and that persons who misuse tax-exempt organization funds will actively conceal information. Some argue that organizations may be reluctant to bring violations of the law to the attention of the IRS or work with the IRS to correct a problem if they know that the violation will be made public. [*Id.* at 66.]

Having acknowledged the risk that tax-exempt organizations would become less forthcoming if the Joint Committee's recommendations are enacted, the staff express confidence that yet other burdens on the tax-exempt community — further reducing "flexibility regarding characterization of expenses," and modifying penalties for violations of the law — would somehow ensure the success of their scheme. Again, the cycle of greater legal fees, fewer charitable services, and reduced oversight of the tax-exempt community can be expected to result.

**2. Increasing the complexity of IRS Form 990 reporting will increase the administrative cost, as well as accounting cost, of preparing and filing these annual forms, with no real benefit to anyone.**

As the Joint Committee staff acknowledges, "[m]ore information is not necessarily better; rather, information needs to be tailored to those who will use it.… Any proposals relating to disclosure should be examined to determine whether they will in fact serve the purposes for which disclosure is made." *Id.*, p. 67.

The Joint Committee staff recognizes this as a significant concern with the Form 990. They cite comments which stated that "the current Form 990, while containing valuable information, may also be confusing, particularly to members of the general public." *Id.* Nevertheless, the staff recommend that the Form 990 be modified to include "information

regarding how well an organization accomplishes its exempt purposes that may not be relevant to whether the organization is complying with the Federal tax laws." *Id.*, p. 90.

Evidently, the staff's view that "information regarding tax-exempt organizations … should be disclosed unless there are compelling reasons for nondisclosure that clearly outweigh the public interest in disclosure" is not even limited to materials with at least an arguable relationship to legal compliance. Tax-exempt organizations would be obliged to present a compelling reason to limit disclosure of any information that could conceivably be asked, so long as such information is allegedly "relevant to the public in order to oversee the tax-exempt sector" *id.*, p. 90 — at least, such is the goal of the Joint Committee staff.

Not that such demands are cost free. The Joint Committee staff observes that there are direct costs of disclosure which should be taken into account — costs which may be quite burdensome to smaller organizations. *Id.*, p. 67. They further suggest analysis of whether the cost of the disclosure is appropriate relative to the public benefit of the disclosure. *Id.*

Thereafter, the study ignores such observations and suggestion. In the staff's detailed recommendations regarding changes to Form 990, the significant cost of increased disclosure was not even discussed, and relief from such burdens is dismissed out of hand. *Id.*, pp. 92-93. Only the interests of state regulators and of those entities which serve as self-appointed guardians of the nonprofit community were deemed worthy of consideration.

### 3. **The public disclosure of pending applications for exempt status (and supporting documents) can be expected to lead to the further politicization of the IRS**

The Joint Committee staff expressed concern that "an organization may be in operation and the public may believe the organization is tax exempt and, in the case of purported section 501(c)(3) organizations, incorrectly assume that donations to the organization are tax deductible." *Id.*, p. 87. Thus, the Staff concluded public disclosure of pending applications should be necessary.

That is an extremely weak argument for increased disclosure. It might be more persuasive if the IRS did not already provide a publication (and Internet access) allowing prospective donors to determine the tax-exempt status of a prospective donation recipient, but there is clearly no need for"reform" in this area. At least the study does not point to any need.

Further, the Joint Committee staff appear oblivious to the resultant danger that this practice would lead to the further politicization of the IRS. Imagine a press report regarding a pending application for tax-exempt status by an organization addressing abortion, or global warming, or international trade. At once, competing interest groups begin to lobby Members of Congress and Administration officials to intervene, either in support of, or opposition to, the application. Or consider the well-connected tax-exempt organization that wishes to avoid competition in representing a given viewpoint. Perhaps an influential public figure

demonstrates his unhappiness with an existing organization by seeking to quash the application of a new group affiliated with the existing organization.

What benefits would result from this publicity which would in any way justify such risks and costs?

**4. The provision of preliminary findings to state officials during the IRS audit process facilitates further harassment of tax-exempt organizations.**

The Joint Committee staff has recommended that the IRS be permitted, prior to a final determination to deny or revoke tax-exempt status, to disclose to State Attorneys General and other nontax State officials or agencies audit and examination information concerning tax-exempt organizations. In addition, the Joint Committee staff has recommended that the IRS be permitted, either upon request or on its own initiative, to share audit and examination information concerning tax-exempt organizations with nontax State officials and agencies with jurisdiction over the activities of such organizations when the IRS determines that such disclosure may facilitate the resolution of cases. *Id.*, at 104.

Purportedly, these recommendations would: (1) enhance the combined efforts of the Federal and State governments to protect the public by promoting the continued flow of information from State officials to the IRS; (2) improve the ability of State officials to monitor compliance with nontax State laws affecting tax-exempt organizations and to enforce and pursue correction of violations of such laws; and (3) facilitate the participation of both the IRS and State officials in the resolution of cases involving significant charitable and fiduciary violations by making more complete information available in earlier phases of such cases to both State officials and the IRS. *Id.*, at 104-05.

Admittedly, this practice would make the punishment of tax-exempt organizations far more efficient. It would certainly "facilitate the resolution of cases" by encouraging state bureaucrats to "pile on" tax-exempt organizations while they are already investing scarce resources in responding to the IRS audit.

But what of the accused? Does the tax-exempt organization become guilty until proven innocent — before two jurisdictions concurrently? What if the organization lacks resources to defend both at once?

## CONCLUSION

FSC strongly opposes the Joint Committee Staff's recommendations because the additional burdens which would be imposed upon tax-exempt organizations (and upon the IRS) would be infinitely greater than any possible public benefit arising from their implementation.

The Joint Committee Staff, while recognizing a tax-exempt organization's right to privacy, appears oblivious to the effect of compelled disclosure on these organizations' First Amendment rights. The U.S. Supreme Court has long recognized "that significant encroachments on First Amendment rights of the sort that **compelled disclosure** imposes cannot be justified by a **mere showing** of **some legitimate governmental interest**. Since NAACP v. Alabama we have required that the subordinating interests of the State must survive **exacting scrutiny**. We also have insisted that there be a 'relevant correlation' or 'substantial relation' between the governmental interest and the information required to be disclosed." Buckley v. Valeo, 424 U.S. 1, 64 (1976), addressing the constitutionality of the Federal Election Campaign Act of 1971. Thus , the Joint Committee Staff's recommendation that exempt organizations be forced to disclose information on the Form 990 — information that expressly has no relation to enforcement of the laws — would appear to explicitly violate the First Amendment protections accorded exempt organizations.

We welcome the opportunity to work with the Committee on this matter so that it may better understand the adverse effects of new burdens being placed upon the nonprofit sector.