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EO JUDICIAL AND ADMINISTRATIVE REVIEW: Allow IRC § 501(C)(4), (C)(5), or (C)(6) Organizations to Seek a Declaratory Judgment to Resolve Disputes About Exempt Status and Require the IRS to Provide Administrative Review of Automatic Revocations of Exempt Status

PROBLEM

Taxpayers seeking exemption as Internal Revenue Code (IRC) § 501(c)(3) organizations may request a declaratory judgment on their exempt status if they meet the requirements of IRC § 7428.¹ Generally, if their applications have been denied or if the IRS fails to make a determination after 270 days, or the IRS has revoked their exempt status, they may request that a court determine whether they are exempt.² In contrast, civic leagues and social welfare organizations seeking exemption as IRC § 501(c)(4) organizations; labor, agricultural and horticultural organizations seeking exemption as IRC § 501(c)(5) organizations; and business leagues, chambers of commerce, real estate boards, or boards of trade seeking exemption as IRC § 501(c)(6) organizations are not entitled to such a declaratory judgment.³ Consequently, there is comparatively little judicial guidance about the requirements for exempt status under IRC § 501(c)(4), (c)(5), and (c)(6), less IRS accountability for delays in processing applications for exempt status under those subsections, and no venue where organizations that disagree with the IRS can directly challenge the IRS's determination.

Organizations whose exempt status is automatically revoked for failing to file required returns or notices for three consecutive years also cannot obtain a declaratory judgment.⁴ Because the IRS has not adopted a meaningful process for administrative review of automatic revocations, these organizations may have no venue, either administrative or judicial, in which to demonstrate the IRS erred in treating them as no longer exempt.

According to the Taxpayer Bill of Rights the IRS adopted on June 10, 2014, taxpayers have the *right to be informed*.⁵ For organizations seeking tax exempt status, the right to be informed means receiving sufficient explanation and guidance about the IRS's—and the courts'—positions as applied to similar facts and circumstances. This in turn allows organizations to determine how to proceed and operate. Taxpayers also have the *right to appeal an IRS decision in an independent forum*, including the IRS Office of Appeals, and they generally have the right to take their cases to court.⁶ By extending declaratory judgment rights to IRC § 501(c)(4), (c)(5), and 501(c)(6) organizations and requiring that the IRS adopt

- 1 A declaratory judgment is “[a] binding adjudication that establishes the rights and other legal relations of the parties without providing for or ordering enforcement.” *Black’s Law Dictionary* (10th ed. 2014).
- 2 See IRC § 7428, providing for judicial review upon exhaustion of administrative remedies. An organization will be deemed to have exhausted its administrative remedies at the expiration of 270 days “if the organization has taken in a timely manner, all reasonable steps to secure such determination.” IRC 7428(b)(2). An important exception, discussed below, is that organizations whose exempt status was automatically revoked pursuant to IRC § 6033(j)(1) are prohibited from bringing an action under the provisions of IRC § 7428. IRC § 7428(b)(4).
- 3 IRC § 7428. As discussed below, although these organizations are not specifically excluded from the provisions of IRC § 7428, they are not included, and there is no other statutory provision allowing them to obtain declaratory judgment relief.
- 4 IRC § 7428(b)(4).
- 5 Taxpayer Bill of Rights, available at <http://www.taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights>, describing taxpayers’ right to be informed.
- 6 *Id.*, describing taxpayers’ right to appeal an IRS decision in an independent forum.

an administrative review process for automatically revoked organizations, Congress can provide these organizations with a readily accessible remedy to enforce these rights where today there is none.

EXAMPLE 1

XYZ, Inc. applies for recognition of exempt status as an IRC § 501(c)(4) social welfare organization. The IRS denies the application on the grounds that XYZ has not demonstrated it is “primarily engaged in promoting in some way the common good and general welfare of the people of the community” as required by the applicable Treasury regulation.⁷ No statutory, regulatory, or judicial authority establishes:

- How to measure the extent of an entity’s social welfare activity;
- Whether exempt status requires a minimum percentage of such activity;
- Whether to consider multiple factors; and if so
- Whether such factors should receive equal weight.

XYZ may administratively appeal the IRS’s determination, but it cannot seek a declaratory judgment from a court that it is exempt. Without exempt status, XYZ will be treated as a taxable entity and will be required to file federal tax returns, and may have to report contributions as income. It may not qualify for state tax exemptions and mailing privileges that would otherwise be available. The absence of public recognition as an exempt organization may deter potential donors from contributing to XYZ in favor of other social welfare organizations whose exempt status has been acknowledged. The cumulative effect of these consequences may be devastating for XYZ.

EXAMPLE 2

ABC, Inc. applied for and was granted exempt status as an IRC § 501(c)(3) organization, but four years later was notified that its exempt status had been automatically revoked for failing to file annual information returns or notices for three consecutive years.⁸ ABC believes the revocation is erroneous. Like XYZ, ABC cannot seek a declaratory judgment from a court regarding its exempt status. Unlike XYZ, ABC does not even have access to an administrative review procedure in which to demonstrate its exempt status was not automatically revoked. As a taxable entity, ABC may also need to report contributions as income on federal tax returns and may no longer qualify for the state tax exemptions and mailing privileges. Donors will no longer be able to claim the charitable contribution deduction for their contributions to ABC, which will severely limit its ability to attract funding compared to when it was exempt. Even those willing to make nondeductible contributions might select another organization acknowledged by the IRS as exempt. The consequences may devastate ABC, even if it later obtains reinstatement of its exempt status.

⁷ Treas. Reg. § 1.501(c)(4)-1(a)(2)(i).

⁸ See IRC § 6033(j), providing for automatic revocation of tax-exempt status of organizations that fail to file required returns or notices for three consecutive years.

RECOMMENDATIONS

To address the lack of judicial review that would provide guidance about the requirements for exempt status as an IRC § 501(c)(4), (c)(5), or (c)(6) organization, and to remedy the lack of administrative appeal procedures in the context of automatic revocations, the National Taxpayer Advocate recommends that Congress:

- A. Amend IRC § 7428 to allow taxpayers seeking exempt status as IRC § 501(c)(4), (c)(5), or (c)(6) organizations to seek a declaratory judgment on the same footing as currently allowed for taxpayers seeking exempt status as IRC § 501(c)(3) organizations.
- B. Amend IRC § 6033(j) to require the IRS to adopt administrative review procedures for organizations treated as having had their exempt status automatically revoked.

PRESENT LAW

Judicial Review of Applications for Exempt Status

Organizations exempt from tax and described under IRC § 501(c)(3) are generally not required to pay tax on income related to their exempt purpose, and may receive tax-deductible contributions.⁹ They must generally apply to the IRS for recognition of exempt status, and if their applications are denied or if the IRS fails to make a determination on their applications after 270 days, or if their exempt status is revoked, they may, under IRC § 7428, seek a declaratory judgment on their status.¹⁰ IRC § 501(c)(4), (c)(5), and (c)(6) organizations are also generally exempt from federal income tax, but contributions to these organizations are generally not tax-deductible.¹¹ These organizations are not required to apply for recognition of exempt status, although many do so by filing Form 1024, *Application for Recognition of Exemption Under Section 501(a)*.¹² They may seek review of a denial of exempt status from the IRS Office of Appeals, but do not have the same right to seek a declaratory judgment as organizations seeking status as an organization described in IRC § 501(c)(3).¹³

A fundamental difference between taxpayers seeking exemption as IRC § 501(c)(3) organizations on the one hand and those seeking exempt status as IRC § 501(c)(4), (c)(5), or (c)(6) organizations on the other hand concerns the amount of permissible lobbying, participation in political campaign activity, or

⁹ See IRC §§ 501 and 170(c)(2). Unrelated business income may be subject to tax. See IRC § 511 *et seq.*

¹⁰ See IRC §§ 508 and 7428.

¹¹ See IRC § 501. Unrelated business income may be subject to tax. See IRC § 511 *et seq.*

¹² The IRS instructions for Form 1024 note that an organization may want to file for recognition in order to obtain certain benefits such as public recognition of tax-exempt status; exemption from certain state taxes; advance assurance to donors of deductibility of contributions (in certain cases); and nonprofit mailing privileges. Some organizations may file because they do not realize they are not required to apply for recognition of exempt status.

¹³ If the IRS Office of Appeals agrees that the organization is not tax exempt, the organization may challenge its non-exempt status by petitioning the U.S. Tax Court for relief following the issuance of a notice of deficiency, if any, or paying any tax owed and seeking a refund in a U.S. district court or the U.S. Court of Federal Claims. IRC §§ 6212, 6213, 7422; 28 U.S.C. § 1346. But by that point, the loss of tax-exempt status may be a fatal blow to the operations of the organization.

engagement in political action.¹⁴ Section 501(c)(3) organizations are permitted to engage generally in only “insubstantial” lobbying activity, and are prohibited from *any* participation or intervention in political campaigns on behalf of (or in opposition to) candidates for public office.¹⁵ IRC § 501(c)(4), (c)(5), or (c)(6) organizations do not face the same statutory or regulatory limitation or prohibition. Generally, they may engage in lobbying without losing their exempt status so long as they primarily engage in activities that further their exempt purpose.¹⁶ They may also participate or intervene in political campaigns so long as they are “*primarily* engaged in promoting in some way the common good and general welfare of the people of the community” (for organizations exempt under IRC § 501(c)(4)). Organizations will not qualify for exempt status under IRC § 501(c)(4), (c)(5), or (c)(6) if their “*primary* purpose or activity” is to engage in political action.¹⁷ There is no statutory or regulatory quantification of the term “*primarily*” or “*primary*” for these purposes.¹⁸

Section 7428 allows section 501(c)(3) organizations to seek a declaratory judgment as to their exempt status if the IRS denies an organization’s application for exemption, fails to act on it, or revokes an organization’s exempt status. The provision was prompted in large part by the Supreme Court’s decisions in two exempt organization cases, *Bob Jones University v. Simon* and *Alexander v. ‘Americans United’ Inc.*¹⁹ The Senate and House reports both quote the Supreme Court’s decision in *Bob Jones University v. Simon* as follows:

Congress has imposed an especially harsh regime on Sec. 501(c)(3) organizations threatened with loss of tax-exempt status and with withdrawal of advance assurance of deductibility of contributions. * * * The degree of bureaucratic control that, practically speaking, has

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- 14 Because the regulations that apply to organizations exempt under other provisions of IRC § 501(c) do not cross reference the regulations under IRC § 501(c)(4) or use the terms “primary” or “primarily” in the same manner (except for the regulations applicable to certain war veterans organizations exempt under IRC § 501(c)(19) which have additional membership requirements) and thus may not be as affected by the attendant lack of judicial interpretation of those terms, we limit this legislative recommendation to IRC § 501(c)(4), (5), and (6) organizations. Moreover, that the IRS has issued guidance on whether public advocacy activities of IRC § 501(c)(4), (5), and (6) organizations constitute exempt function expenditures under IRC § 527(e)(2) and would therefore not be subject to tax under IRC § 527(f)(1) suggests that these organizations are more apt to engage in political activity and would consequently benefit most from the availability of judicial review. See Rev. Rul. 2004-6, 2004-1 C.B. 328.
- 15 See Treas. Reg. § 1.501(c)(3)-1(b)(3)(i), providing that an organization “is not organized exclusively for one or more exempt purposes if its articles expressly empower it: (i) To devote more than an insubstantial part of its activities to attempting to influence legislation by propaganda or otherwise”; IRC § 501(c)(3), providing that a charity may “not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.”
- 16 See Ellen P. Aprill, *Regulating the Political Speech of Noncharitable Exempt Organizations After Citizens United*, 10 Elec. Law J. 363, 376 (2011), noting “Thus, under various administrative authorities of various official weights, section 501(c)(4), (5), and (6) organizations can all lobby without limit, so long as they can show that such lobbying is related to their exempt purposes.”
- 17 See IRC § 501(c)(4)(A), allowing an exemption for organizations “operated exclusively for the promotion of social welfare”; Treas. Reg. § 1.501(c)(4)-1(a)(2)(i), providing that “an organization is operated exclusively for the promotion of social welfare if it is *primarily* engaged in promoting in some way the common good and general welfare of the people of the community.” (emphasis added); Treas. Reg. § 501(c)(4)-1(a)(2)(ii), providing that promoting social welfare does not include participation or intervention in political campaigns; General Counsel Memorandum 34,233 (Dec. 3, 1969), noting that an organization would not qualify for exempt status under section 501(c)(5) or (c)(6) “if the *primary* purpose or activity of an organization is to engage in political action.” (emphasis added).
- 18 See Legislative Recommendation: SECTION 501(c)(4) POLITICAL CAMPAIGN ACTIVITY: Enact an Optional “Safe Harbor” Election That Would Allow IRC § 501(c)(4) Organizations to Ensure They Do Not Engage in Excessive Political Campaign Activity, *supra*.
- 19 S. REP. No. 94-938, at 586 (1976); H.R. REP. No. 94-658, at 283 (1975), referencing *Bob Jones University v. Simon*, 416 U.S. 725 (1974) and *Alexander v. ‘Americans United’ Inc.*, 416 U.S. 752 (1974). See also Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976*, 94th Cong., 2d Sess. 401 (Dec. 29, 1976) (same). The reports all also note that Congress had recently given the Tax Court jurisdiction to hear declaratory judgment suits as to the status of certain employee retirement plan status in the Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, § 1041, 88 Stat. 829, 949 (1974), adding IRC § 7476.

been placed in the Service over those in petitioner's position (*i.e.*, the position of Bob Jones University) is susceptible to abuse, regardless of how conscientiously the Service may attempt to carry out its responsibilities. Specific treatment of not-for-profit organizations to allow them to seek pre-enforcement review may well merit consideration.²⁰

Both reports also contain the following note:

The Court's opinion [in *Bob Jones University v. Simon*] noted that former Internal Revenue Commissioner Thrower had criticized the present system for resolving such disputes between the Service and the organization.

This is an extremely unfortunate situation for several reasons. First, it offends my sense of justice for undue delay to be imposed on one who needs a prompt decision. Second, in practical effect it gives a greater finality to IRS decisions than we would want or Congress intended. Third, it inhibits the growth of a body of case law interpretative of the exempt organization provisions that could guide the IRS in its further deliberations. (*Thrower, IRS Is Considering Far Reaching Changes in Ruling on Exempt Organizations*, 34 *Journal of Taxation* 168 (1971).)²¹

In other words, the House and Senate reports suggest that Congress believed the absence of judicial review of IRC § 501(c)(3) determinations left organizations subject to undue delay, conferred too much power on the IRS, and impeded interpretive case law. And Commissioner Thrower's remarks show that the IRS, at least in 1971, agreed.

In 1976, Congress enacted IRC § 7428, giving organizations seeking exempt status as an IRC § 501(c)(3) organization the right to obtain a declaratory judgment from the United States Tax Court, the United States Court of Federal Claims, or the district court of the United States for the District of Columbia.²² The question had been raised whether to extend the availability of declaratory judgment suits to other types of exempt organizations ("such as... a social welfare organization under 501(c)(4), a fraternal organization under 501(c)(8), or a cemetery company under 501(c)(13)"), but the statute as enacted did not provide for such access.²³

20 S. REP. No. 94-938, at 586 (1976); H.R. REP. No. 94-658, at 284 (1975). See also Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976*, 94th Cong., 2d Sess., 401-402 (Dec. 29, 1976) (same).

21 S. REP. No. 94-938, at 586 n. 649 (1976); H.R. REP. No. 94-658, at 284 n. 216 (1975). See also Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976*, 94th Cong., 2d Sess., 401-402 n. 4 (Dec. 29, 1976) (same).

22 Tax Reform Act of 1976, Pub. L. No. 94-455, §1306(a), 90 Stat. 1520, 1717 (1976). Though not articulated in the statute, the legislative history makes clear that the Tax Court would have flexibility in assigning petitions for declaratory judgments to special trial judges. See S. REP. No. 94-938, at 591 (1976); H.R. REP. No. 94-658, at 288 (1975). See also Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976*, 94th Cong., 2d Sess., 406 (Dec. 29, 1976) (same).

23 See Joint Comm. on Int. Rev. Tax'n, 94th Cong. 2d Sess., *Tax Revision Issues - 1976 (H.R. 10612)*, No. 6, *Administrative Matters* 5-6, (Comm. Print 1976) available at <https://www.jct.gov/publications.html?func=startdown&id=3848>.

No explanation for the omission appears in the legislative reports.²⁴ However, the legislative history makes clear that Congress intended to monitor this aspect of exempt organization law.²⁵

Perhaps for the same reasons Congress established judicial review of IRC § 501(c)(3) applications, some members have concluded judicial review should be extended, at least to IRC § 501(c)(4) applicants. Early in 2014, the Chairman of the House Ways and Means Committee released draft legislation that contained such a provision.²⁶

Administrative Review of Automatic Revocations

In 2006, Congress enacted section 1223 of the Pension Protection Act of 2006 (PPA), imposing reporting requirements on certain organizations not previously required to file returns, and providing for automatic revocation of exempt status for failing to file required returns or notices for three consecutive years.²⁷ The PPA amended IRC § 7428 to specifically preclude organizations whose tax-exempt status was automatically revoked from bringing declaratory judgment actions.²⁸ The PPA does not prohibit administrative review of an IRS conclusion that an organization's exempt status was automatically revoked. However,

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- 24 Some insight about the reason for the omission may be found in the explanation the Tax Section of the American Bar Association (Tax Section) provided for its 1974 recommendation that IRC § 7428 be amended to allow IRC § 501(c)(3) organizations to obtain declaratory judgments. The Tax Section noted that it had considered expanding the remedy to all exempt organizations, but concluded that because IRC § 501(c)(3) organizations may receive deductible contributions and are therefore more directly harmed by doubts regarding their status than other exempt organizations to which contributions are not tax deductible, “such an expansion is not required at this time.” As for other types of IRC § 501(c) organizations that may receive deductible contributions (e.g., veterans’ organizations, fraternal lodges, or cemetery societies), they would not be as affected by doubt about their status as 501(c)(3) organizations because “[c]ontributions to this type of organization are typically made by a membership group which is likely to continue to support the organization even if a question is raised as to its status.” American Bar Association Tax Section Recommendation No. 1974-17, reported in 28 *Tax. Law.* No. 3, 431, 434 (Spring 1975).
- 25 The House and Senate reports both noted: “In connection with this, and as an aid to proper oversight and to future decision-making in this area, the committee intends that the Internal Revenue Service report annually to the tax-writing committee of the Congress on the Service’s activities with regard to organizations exempt under section 501(a), including the following: (1) the number of organizations that applied for recognition of exempt status, (2) the number of organizations whose applications were accepted and the number of organizations whose applications were denied, (3) the number of organizations whose prior favorable ruling letters were revoked, (4) the number of organizations that were audited during the year, and (5) the number of organizations that the Service regards as being exempt. To the extent possible, these statistics should be broken out by type of organization (e.g., public charity, private foundation, social welfare organization, fraternal beneficial association, and veterans’ organization).” S. REP. No. 94-938, at 586 (1976), H.R. REP. No. 94-658, at 285 (1975). The IRS reported some of this data in 1976 and each year thereafter in its annual Statistics of Income Data Book. See IRS Statistics of Income Data Book available at <http://www.irs.gov/uac/SOI-Tax-Stats-IRS-Data-Book>. The reports include the number of applications processed (rather than the number received) and do not include the number of revocations.
- 26 See U.S. Congress, House Committee on Ways and Means, The Tax Reform Act of 2014, § 6002, 113 Cong., 2 sess., Feb. 2014, available at http://waysandmeans.house.gov/uploadedfiles/statutory_text_tax_reform_act_of_2014_discussion_draft_022614.pdf.
- 27 Pension Protection Act of 2006, Pub. L. No. 109-280 § 1223, 120 Stat. 780, 1090 (2006), adding to IRC § 6033 subsections (i) and (j).
- 28 Pension Protection Act of 2006, Pub. L. No. 109-280, § 1223(c), 120 Stat. 780, 1090 (2006), adding to IRC § 7428 subsection (b)(4), providing that “[n]o action may be brought under this section with respect to any revocation of status described in section 6033(j)(1).”

despite the National Taxpayer Advocate's repeated recommendations to the IRS to do so, the IRS does not provide such review.²⁹

On June 10, 2014, the IRS adopted the Taxpayer Bill of Rights. These rights include taxpayers' *right to be informed*, *i.e.*, "the right to know what they need to do to comply with the tax laws. They are entitled to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices, and correspondence. They have the right to be informed of IRS decisions about their tax accounts and to receive clear explanations of the outcomes."³⁰ Taxpayers also have the *right to appeal an IRS decision in an independent forum*, *i.e.*, they are entitled to "a fair and impartial administrative appeal of most IRS decisions, including many penalties, and have the right to receive a written response regarding the Office of Appeals' decision. Taxpayers generally have the right to take their cases to court."³¹

REASONS FOR CHANGE

Judicial Review of Applications for Exempt Status

Congress enacted IRC § 7428 in the light of Supreme Court cases that involved IRC § 501(c)(3) organizations. Lack of access to a declaratory judgment would indeed be a "harsh regime" for section 501(c)(3) organizations, contributions to which may be deductible, but this lack of access may also cause hardship on other section 501(c) organizations. A potential contributor to a section 501(c)(4), (c)(5), or (c)(6) organization would not generally expect his or her contribution to be deductible. Thus, in choosing among organizations to receive a nondeductible contribution, public recognition of exempt status may be the *only* basis for selecting one organization over another. The donor is assured that the contribution will not be a taxable receipt, and public recognition that results from IRS vetting may increase his or her confidence in the organization's legitimacy. Thus, IRS recognition may be just as vital to the continued existence of section 501(c)(4), (c)(5), or (c)(6) organizations as it is for section 501(c)(3) organizations, and doubt about exempt status just as harmful.

In any event, as noted above, Congress intended to monitor the volume and type of exempt organization applications "as an aid to proper oversight and to future decision-making in this area."³² A significant increase in volume would presumably indicate that additional or different oversight would be appropriate. As the Treasury Inspector General for Tax Administration (TIGTA) reported, over the four-year period

29 See National Taxpayer Advocate 2013 Annual Report to Congress 165, 172 (*Most Serious Problem: EXEMPT ORGANIZATIONS: The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status*); 2012 Annual Report to Congress 192, 200 (*Most Serious Problem: Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process Are Burdening Tax-Exempt Organizations*); National Taxpayer Advocate 2011 Annual Report to Congress 442, 444 (*Most Serious Problem: The IRS Makes Reinstatement of an Organization's Exempt Status Following Revocation Unnecessarily Burdensome*); National Taxpayer Advocate 2011 Annual Report to Congress 562 (*Legislative Recommendation: Provide Administrative Review of Automatic Revocations of Exempt Status, Develop a Form 1023-EZ, and Reduce Costs to Taxpayers and the IRS by Implementing Cyber Assistant*). See, e.g., Automatic Exemption Revocation for Non-Filing: Frequently Asked Questions (rev. Sept. 23, 2014), available at <http://www.irs.gov/Charities-&-Non-Profits/Automatic-Exemption-Revocation-for-Non-Filing:-Revocation-Cannot-Be-Appealed>, answering the question "May my organization appeal its automatic revocation?" with "No, the law provides no appeals process for automatic revocations. To have its tax-exempt status reinstated, the organization must file an application for exemption. An organization may also request retroactive reinstatement as part of its application." Organizations that believe the IRS erroneously listed them as having had their exempt status automatically revoked are advised to simply contact the IRS. There is no mechanism for review of disputed cases.

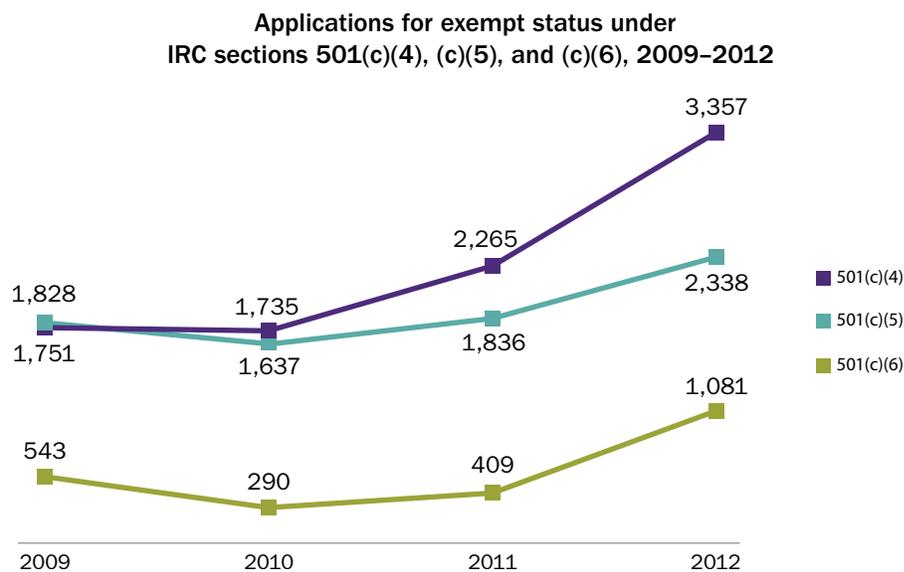
30 Taxpayer Bill of Rights, available at <http://www.taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights>, describing taxpayers' right to be informed.

31 *Id.*, describing taxpayers' right to appeal an IRS decision in an independent forum.

32 See S. REP. NO. 94-938, at 586 (1976), H.R. REP. NO. 94-658, at 285 (1975).

from 2009 to 2012, the number of taxpayers seeking exempt status as IRC § 501(c)(4), (c)(5), and (c)(6) organizations increased 92 percent, 99 percent, and 28 percent, respectively, as shown in Figure 2.12.1.³³

FIGURE 2.12.1



More importantly, as TIGTA also reported, lack of guidance may have contributed to the IRS's adoption of inappropriate procedures for evaluating IRC § 501(c)(4) applications and a 13-month processing stoppage, conditions that increases in application volume only exacerbated.³⁴ The availability of declaratory judgments would have allowed judicial guidance to emerge where administrative guidance was lacking or inappropriate, preventing the violation of taxpayers' *right to be informed*.³⁵

33 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2013-10-053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review 3* (Figure 2) (May 14, 2013), reporting the number of applications for exempt status under IRC § 501(c)(4) was 1,751 in fiscal year (FY) 2009; 1,735 in FY 2010; 2,265 in FY 2011, and 3,357 in FY 2012. Applications for exempt status under IRC § 501(c)(5) were 543, 290, 409, and 1,081; and under IRC § 501(c)(6) were 1,828, 1,637, 1,836, and 2,338 in the same respective periods. The number of applications for exempt status under IRC § 501(c)(3) increased only two percent from FY 2009 to FY 2012, with 65,179 applications in FY 2009; 59,486 in FY 2010; 58,712 in FY 2011; and 66,543 applications in FY 2012.

34 *Id.* at 12-13. See also United States Senate, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, *IRS And TIGTA Management Failures Related To 501(c)(4) Applicants Engaged In Campaign Activity* at 17 (Sept. 5, 2014), available at <http://www.hsgac.senate.gov/subcommittees/investigations/reports>, noting that “[m]ost of the court decisions have interpreted the law with respect to 501(c)(3) charities as opposed to social welfare organizations, or examined the term ‘exclusively’ in other contexts.” (Fn. ref. omitted).

35 It is for this reason that the National Taxpayer Advocate, in her FY 2014 Objectives Report to Congress, included a Special Report, *Political Activity and the Rights of Applicants for Tax-Exempt Status* (Special Report), in which she further analyzed the causes of the problems TIGTA identified and suggested that Congress “[c]onsider legislation to provide applicants for exemption under IRC § 501(c)(4) with the ability to seek a declaratory judgment if denied or unanswered after nine months so that more judicial guidance can develop.” Special Report at 15-16.

Administrative Review of Automatic Revocations

Organizations whose exempt status (under any subparagraph of 501(c)) was automatically revoked not only cannot seek a declaratory judgment under IRC § 7428, but also cannot access an administrative review procedure. The IRS has erroneously treated thousands of organizations as having had their exempt status automatically revoked and has adopted computer programming that will lead to additional erroneous revocations.³⁶ Despite the urging of the National Taxpayer Advocate and the IRS's adoption of the Taxpayer Bill of Rights (TBOR), which includes “administrative appeal of most IRS decisions ...,” the IRS refuses to develop procedures that would allow organizations to demonstrate they remain exempt before the IRS erroneously lists them on public databases as non-exempt. The consequences of being listed as no longer exempt, such as declining contributions and a loss of credibility, and the time and expense of seeking reinstatement, may devastate an organization.

EXPLANATION OF RECOMMENDATIONS

The first proposal, consistent with taxpayers' *rights to be informed* and *to appeal an IRS decision in an independent forum*, would amend IRC § 7428 to allow taxpayers seeking exemption as IRC § 501(c)(4), (c)(5), or (c)(6) organizations to seek a declaratory judgment on the same footing as those seeking exempt status as IRC § 501(c)(3) organizations. This would ensure that these non-501(c)(3) organizations could obtain relief if their applications remain unaddressed for nine months, increase IRS accountability for delays, and allow judicial guidance to develop. The recommendation is limited to IRC § 501(c)(4), (5), and (6) organizations, who are most affected by the lack of judicial guidance in this area.

The second proposal, consistent with taxpayers' *right to appeal an IRS decision in an independent forum*, would amend IRC § 6033(j) to require the IRS to adopt administrative review procedures for organizations whose tax-exempt status is treated as automatically revoked. This would provide organizations with a venue in which to raise their concerns and help the IRS avert errors that could prove fatal to the organizations. Instituting such a procedure would be good tax administration, especially in the absence of access to a judicial forum under IRC § 7428 in which an organization can show an automatic revocation was erroneous.

36 National Taxpayer Advocate 2013 Annual Report to Congress 165 n. 5, 169-171, Most Serious Problem: *EXEMPT ORGANIZATIONS: The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status* (noting that TE/GE estimates it erroneously treated about 9,000 organizations as having had their exempt status automatically revoked and will continue to measure the three year nonfiling period from the time an organization obtains its employer identification number, whether or not the organization had a filing requirement).