SIMULTANEOUS CONTRASTS IN THE U.S. LAW AND REGULATION OF CHARITIES

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Whether you call them duplications, splits, or conflicts, three fundamental dualities characterize American charity regulation. In terms of organisational law, the law of trusts and nonprofit corporations essentially operate in parallel, without so much as acknowledging each other. Within a state, we often find separate definitions of charity for regulatory and tax exemption purposes - particularly tighter definitions for state property tax exemption. Finally, the overlap of substantive and tax regimes can clash with the authority of attorneys general in protecting assets held by entities that lose or fail to achieve tax exemption. While dual federal and state oversight raises concerns of federalism, recent challenges to the legitimacy of the Internal Revenue Service's handling of applications for exemption for '501(c)(4)' organisations engaged in political activity threatens that agency's overall role in charity oversight.

Introduction: No Single Law (or Definition) of Charity

US law does not neatly address charities in a single body of law. Much of the common law relating to charity, property, and wills and trusts has found its way into separate state statutes, and significant gaps remain in the laws regulating charity because of the infrequency in enforcement action or litigation and a lag in statutory revision.

As a result, legal speakers as well as laymen often misleadingly conflate the terms 'charitable', 'nonprofit', 'tax exempt', and '§ 501(c)(3)' organisations. While the term 'charity' has its origins in the Statute of Charitable Uses' broad conception of public benefit, to modern Americans the term often calls to mind alms-giving, anti-

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poverty, or at least purely donative efforts. Nonprofit organisations include not just philanthropic organisations, but also mutual benefit organisations such as social clubs, labor unions, and trade associations. Mutual-benefit organisations as well as charities enjoy federal income tax exemption, albeit under different subsections of Internal Revenue Code § 501(c). Importantly, though, some charities (particularly those engaged in significant lobbying) are ineligible for the most-favoured status of § 501(c)(3), and are instead exempt under § 501(c)(4) - or not exempt at all. At the state level, a nonprofit organisation (mutual or charitable) might be exempt from income tax but not from property tax.

Trust and corporate organisational law

Available organisational forms

Charities usually organise under state law as either charitable trusts or nonprofit corporations. The many charities formed as unincorporated nonprofit associations tend to be small and informal.[1] The 2008 redesigned Form 990 - filed with the Internal Revenue Service (IRS) by most large federally tax exempt charities - might be the best source of statistical data on organisational form.[2]

A charity is characterised by its lack of shareholders (or members entitled to any distribution of profits or earnings). Assuring that a charity cannot operate for impermissible private benefit is easier under the law of trusts, which distinguishes between charitable trusts and private trusts, than under nonprofit corporate law. The organisational documents of both nonprofit corporations and unincorporated nonprofit associations seeking to qualify for tax exemption as charities must recite charitable purposes and the appropriate limitations. State nonprofit corporation or other statutes typically provide enhanced attorney general and judicial supervision over charities as distinguished from mutual-benefit organisations.

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1 Absent a statute, unincorporated nonprofit associations traditionally function under the laws of co-ownership and agency, complicating title to association assets and potentially exposing the members and officers to personal liability for association activities. See e.g. Revised Uniform Unincorporated Nonprofit Association Act (2008) available at www.uniformlaws.org

2 According to a 23 June 2014 email from Paul Arnsberger, IRS Statistics of Income Division, of the 186,417 § 501(c)(3) organisations filing the Form 990 for 2010: 3,609 were associations (2%); 165,758 were corporations (89%); 3,684 were trusts (2%); 4,391 took another form (2%); and 8,975 left the question blank (5%). Unfortunately, only about 35% of all tax exempt filing charities report on the Form 990; smaller organisations file the shorter Form 990-EZ; and those with revenues normally less than $50,000 file only the bare-bone 'e-Postcard' (Form 990-N).

While American charity organisers favour the corporate form,[3] the trust form might be appropriate for a charity (such as a grant-making foundation) that manages a fund of money and makes designated distributions. The trust form is also useful in certain situations, including when speed of formation is important (a trust requires no certificate from a state official[4]); to avoid mandatory provisions of corporate law, such as mandatory meetings, annual reports and filing fees, or a minimum number of directors; and to assign different functions (such as administration and distribution) to different trustees.[5] It is common for a charitable trust instrument to permit the trustees to incorporate the charity, a power often triggered after the initial trustees have moved on.

Legal consequences of choice of organisational form

As expressed by the Delaware Supreme Court, the creator's choice of the legal form for a charity, like donor intent generally, is entitled to deference.[6] Importantly, the choice of form can signal the creators' and constituents' intent as to what procedural law will apply. Trustees of a charitable trust are bound by the instructions of the settlor, and any departure from the terms of the trust instrument requires court approval.[7] The constitution (or other organisational document) of an unincorporated association (and some religious societies) usually may not be amended without approval by its members. The directors of a nonprofit corporation generally need not apply to court in such circumstances as replacing a director or amending the articles of incorporation (although amendment of the articles often requires the assent of members, if any). In practice, however, most limits on the operation of trusts are default rules that allow for tailoring that minimises the differences in legal form; notably, the well-drafted trust instrument

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3 The American preference for the corporate form results from a combination of historical accident and institutional forces, initially New York's failure to recognize the charitable trust until the end of the 19th century, and the use of New York laws as models for many of the states that later joined the United States.

4 However, today the issuance of a certificate of nonprofit incorporation is a ministerial duty; the Secretary of State cannot deny a certificate so long as the organisation has complied with the procedural requirements.

5 For more discussion of the regimes applying to charities of different legal forms, see Carolyn C Clark and Glenn M Troost, 'Forming a Foundation: Trust vs Corporation' (May/June 1989 3 Prob & Prop 1, 2); Evelyn Brody, 'Charity Governance: What's Trust Law Got to Do With It?' (2005) 80 Chi-Kent L Rev 641.

6 See *Oberly v Kirby*, 592 A.2d 445, 466-67 (Del 1991) (citation omitted).

7 For the updated approach, see §§ 66 and 67 of the Restatement Third of Trusts. For similar rules in the American Law Institute's draft Principles of the Law of Charitable Nonprofit Organizations, see Tentative Draft No 2 (2009) § 460 (Judicial Modification Proceeding: Deviation and Cy Pres); see also ibid, § 400 for the treatment of restricted and conditional gifts donated to charitable nonprofit corporations.

will provide for the desired level of flexibility in governance (such as providing a non-judicial process to make amendments or select successor trustees).

The desire for federal income tax exemption reduces differences in organisational form. A charity founder cannot waive the requirements of the Internal Revenue Code and Treasury regulations if the charity expects to obtain federal tax exemption.

Change of charitable purpose

As much as possible, the ongoing American Law Institute (ALI) drafting project on Principles of the Law of Charitable Nonprofit Organizations seeks to craft legal principles that apply regardless of organisational form.[8] So far, the corporate approach generally applies to the exercise of fiduciary duties (see Chapter 3, in Tentative Draft No 1 (2007 and 2008)); trust rules generally apply as well to gifts restricted by donors to specified purposes (see Chapter 4, in Tentative Draft No 2 (2009)); and the same public and private enforcement rights generally apply to all charities (see Chapter 5, in Tentative Draft No 3 (2012) and No 4 (2013)). However, the issue of changes in charitable purpose brings to the fore a clash between the two fundamental regimes of trust and corporate law.

Changing from one charitable purpose to another charitable purpose comprises both a procedural and a substantive aspect. As a matter of process, what is - and should be - the role of the state, specifically the attorney general (who represents charities' beneficiary classes) and the courts? As for the legal standard, must the charity satisfy the *cy-près* requirements by showing that the current purpose can no longer be carried out and that the new purpose is close to the old purpose?

The drafters of the Revised Model Nonprofit Corporation Act[9] expressed concern about whether a corporate charity can alter its purposes without following the trust-law process of applying to court for *cy-près* relief, quoting the classic articulation:[10]

> Those who give to a home for abandoned animals do not anticipate a future board amending the charity's purpose to become research vivisectionists.

8 See generally Evelyn Brody, 'US Nonprofit Law Reform: The Role of Private Organizations' (2012) 41(4) NONPROFIT & VOLUNTARY SECTOR Q 535-559.

9 The Revised Model Nonprofit Corporation Act (1987) was enacted (with some variation) in almost half the states. The Nonprofit Organizations Committee of the American Bar Association's Business Law Section adopted the Model Nonprofit Corporation Act, 3rd edn in 2008; it has been enacted in the District of Columbia and is under consideration in Vermont.

10 See *Attorney General v Hahnemann Hospital* 494 NE 2d 1011, 1021 n 18 (Mass 1986).

Nevertheless, the Revised Model Act merely focuses on the post-amendment use of the assets; the Official Comment to § 10.08 (Effect of Amendment and Restatement) states:

> If a public benefit or religious corporation amends its articles to change its purposes, property held by the corporation immediately prior to the effective date of the amendment may remain subject to a limitation based on the prior articles or to restrictions imposed by the donor of the property.

Compare § 10.09 of the Model Nonprofit Corporation Act, Third Edition (2008), which similarly focuses on the assets ('Property held in trust by a nonprofit corporation or otherwise dedicated to a charitable purpose may not be diverted from its purpose by an amendment of its articles of incorporation unless. . .'). By contrast, New York requires either approval by the attorney general or the court to an amendment to the purpose of the charitable corporation.[11]

Some commentators advocate a compromise approach: to distinguish between shifting purposes within the same field or expanding the charitable class, on the one hand, and substantial changes of purpose (as in the anti-vivisectionist example), on the other hand. Change of purpose in the latter category might be subjected to greater public oversight or to an elevated standard of review. For example, a college - whether financially healthy or struggling - might be permitted to close a department without resort to the attorney general and courts, but liquidation or merger might require notice and approval. Such a line is not always easy to draw: The decision by the board of a women's college to admit men could be viewed alternatively as a mere enlargement of the charitable class or as a repudiation of the original charitable purpose. As a practical matter, moreover, disagreements will arise whether a charity has changed its purpose when its

11 In late 2013, the governor of New York signed a major overhaul of the state's nonprofit corporation statute. Non-Profit Revitalization Act of 2013, Assembly Bill 8072, 2013 NY Laws, ch 549 (18 December 2013). As amended by Bill § 82, § 804(a)(ii) of New York's Not-for-Profit Corporation Law provides that the certificate of amendment of a 'charitable' corporation 'which seeks to change or eliminate a purpose or power enumerated in the corporation's certificate of incorporation ... shall have endorsed thereon or annexed thereto the approval of either (A) the attorney general, or (B) a justice of the supreme court ... At any time, including if the attorney general does not approve a certificate of amendment ... or if the attorney general concludes that court review is appropriate, the corporation may apply for approval of the amendment to a justice of the supreme court ... Any application for approval of a certificate of amendment by the supreme court pursuant to this paragraph shall be on ten days' written notice to the attorney general'. A quasi *cy-près* proceeding might be required; see *Alco Gravure, Inc v Knapp Foundation* 479 NE 2d 752 (NY 1985).

activities have evolved.[12] Importantly, some courts, notably those in California, prohibit a charity from 'abandoning' its purpose as expressed through its operations.

Turning to the question of post-amendment use of assets, it is useful to view nonprofit corporate assets other than restricted or conditional gifts as falling into two general categories: unrestricted gifts and non-donated assets (i.e., earned income and investment returns). The investment return on restricted and conditional gifts is treated as restricted or unrestricted depending on state law[13] and on the agreement with the donor (as stated in the gift instrument and the institution's gift acceptance policy). In some states, though, statutes (or regulators or courts) take a different approach, and treat all assets held by a corporate charity as impressed with the pre-amendment purposes. The most conceptually difficult is the category of unrestricted gifts - that is, gifts made for general corporate purposes. Whether these may be used for any post-amendment purposes depends on whether these gifts are viewed as restricted to the charitable purpose of the corporation at the time the gifts were made.

For a charity other than a trust, the approach I drafted as Reporter of the ALI project in Preliminary Draft No 6 (2013) provides that a decision to change from one charitable purpose to another charitable purpose is treated like any other charter amendment: that is, is left to the charity's board, with the approval of voting members (if any). Moreover, my draft § 270 explicitly provides that, unless otherwise required by state law or the organisational documents, the non-trust charity's governing board need not determine that the current purpose of the charity has failed. My draft statement of the principle provides that the decision is reviewable only for abuse of discretion; the draft commentary describes an intermediate level of review applied by some courts (see above). Note that my approach would not limit the state's authority to address issues of self-dealing or other improper fiduciary behavior.

Separately, my companion draft § 290 discusses the effect of a change in charitable purpose on existing assets. If the standard for amending purpose is the *cy-près* standard, then almost by definition the old assets will have to be redirected somewhere - either to the new purpose of the original charity, or transferred to

12 A fundamental restructuring or other transaction does not necessarily result in a change of purpose (although it might amount to a change of a type requiring state notification and, perhaps, approval). The use of for-profit or nonprofit 'subsidiaries,' joint ventures, and changes in operations through management contracts raise challenging issues of governance, but do not so clearly amount to a change of control because of the charity board's continuing responsibility with respect to the assets.

13 For example, whether the gift is an institutional fund under the Uniform Prudent Management of Institutional Funds Act.

another charity with the same (or modified) purpose as the old one. My flexible approach, by contrast, preserves an explicitly restricted gift for the purposes permitted by the gift instrument, but generally permits the charity to use other assets for any charitable purpose set forth in its amended organisational documents. Some courts, by contrast, have held that even unrestricted gifts, as well as earned income and investment income, are impressed with the pre-amendment purposes of a donee charity.

Besides reflecting what I believe is already current corporate law (at least in most states), my approach reflects a general policy favouring the board's authority to adapt to changes in purpose. As is true with the longstanding debate under trust law over the dead hand and *cy-près* reform, the law must balance historical purpose against current need. I worry about unduly encouraging the expectation that charity managers must honour the original purposes of the charity. Fiduciaries might reasonably believe that it is legally safer to stay the course while the organisation stagnates, if not deteriorates. Under my approach, a charity's specific purposes will be transparent. By contrast, under a less flexible legal framework, advisors will recommend that a new charity should adopt as broad a purpose clause as possible, to forestall a costly process of amendment when, inevitably, the charity incrementally evolves. Moreover, my approach respects the founder's choice of corporate form rather than trust form, and the resulting legal flexibility of that form; a founder seeking court involvement and limited change of purpose could instead choose a charitable trust.[14]

In effect, my approach operates as a default rule as to donated assets. It is based on the policy, described in draft § 400, that American law does not infer restrictions on the alienation and use of property. Section 400 provides a bright-line rule that allows a donor to impose restrictions and conditions, as long as those terms are express. More broadly, draft Chapter 4 permits donors who want to impose restrictions to do so; presumes that donors who make general gifts appreciate that charities must adapt to changing circumstances; and views

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14 In the context of the sale of nonprofit hospitals, the Supreme Courts of Kansas, Mississippi, and Massachusetts applied nonprofit corporate law, not trust law, in cases where the hospital assets were not acquired under an explicit trust. See *City of Picayune v Southern Regional Corp* 916 So 2d 510, 523 (Miss 2005) ('As a general rule, the courts refrain from interfering with the internal management of a corporation and do not interfere in the affairs of a private corporation in the absence of proof of bad faith or fraud on the part of those entrusted with its management.'). The Mississippi High Court cited *Kansas East Conference of United Methodist Church, Inc v Bethany Medical Center, Inc* 969 P 2d 859 (Kan 1998). See also *Attorney General v Hahnemann Hosp* (n 10) 1020-21, in which the Massachusetts High Court rejected the attorney general's argument that the board of a nonprofit corporation could not amend its articles to adopt new purposes for *future* activities and gifts.

unrestricted gifts as being expended first, and so used to satisfy any intended (but unexpressed) intention of the donors.[15]

Two of the ALI working group members favoured a uniform approach under which a corporate change of charitable purpose must generally follow the trust law requirements of consultation with the attorney general and judicial approval, applying the *cy-près* doctrine. At the same time, they would define change of purpose narrowly, so it would be rare, and liberalize the *cy-près* doctrine beyond what appears in the ALI's Restatement Third of Trusts § 66. Adopting their alternative approach would require the ALI to revisit decisions tentatively approved in earlier drafts of the project.[16] With the ALI project now continuing under these two working-group members (succeeding me as co-Reporters), we can expect their alternative treatment of change of charitable purpose (and necessary conforming changes to other draft chapters) to be presented to the ALI Council and membership.

A board-deferential approach to corporate change in charitable purpose was recently endorsed by law professor Johnny Rex Buckles.[17] Buckles develops a framework of 'fidelity norms', finding that '[so]me states rely on trust law principles and impose the static charter fidelity norm on directors, whereas others apply corporate law concepts broadly and hold directors to the dynamic charter fidelity norm'.[18] Through an efficiency lens, Buckles observes:[19]

> A governing board is not usually required to seek advance state approval to enlarge its facilities, double its workforce, expand its customer base, relocate, obtain a loan, or radically alter its investment portfolio. If fiduciaries are assumed to be capable of making these changes, why should the law not assume that they are also capable of deciding upon changes in purpose and mission?

15 See also draft § 440, Comment *a*, discussing the policy reasons for relaxing a restriction on a gift after the passage of time.

16 See Tentative Draft No 1 (Governance), § 320, Comment *e*, which rejected a duty of obedience in favour of a duty to keep the purpose of the charity current and useful; and Tentative Draft No 2 (Gifts), § 400, Comment *d(3)*, which rejected treating unrestricted gifts as restricted to corporate purposes and § 460, which adopts the standard of *cy-près* included in the Restatement Third of Trusts.

17 Johnny Rex Buckles, 'How Deep Are the Springs of Obedience Norms that Bind the Overseers of Charities' (2013) 82 CATH U L REV 913.

18 ibid 950.

19 ibid 947 (footnotes omitted).

Nor does Buckles find that a static obedience norm is efficient with respect to donors.[20] With respect to the standard of judicial review, he comments that if his premise for applying dynamic obedience norms 'is correct, some degree of judicial deference to the decisions of directors is warranted'.[21]

State Property Tax Exemption

State laws define charity more or less broadly depending on the policy interest. For example, the state might want a broad definition in order to regulate 'charity' fund-raising but a narrow definition for purposes of tax exemption.[22] Notably, 17 state constitutions grant property tax exemption to 'institutions of purely public charity' (or a similar term), while 25 constitutions grant the legislature authority to exempt charities.[23] In defining 'institution of public charity,' some state High Courts adopted a multi-factor test. These tests typically call for the charitable property owner to demonstrate that the charity (and its use of the property):

- benefits the general welfare of an indefinite number of persons, and renders gratuitously a substantial portion of its services;
- does not result in private benefit or profit;
- operates mainly from donations;
- reduces the burdens of government; and,
- dispenses charity to all who need and apply for it (sometimes phrased as: 'no obstacles are placed in the way of those seeking the benefits').

These factors - particularly those requiring some level of donative support and gratuitous expenditure, absence of profit, and reducing governmental burdens - are

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20 ibid 959 (footnotes omitted) ('In brief, (1) it is unclear that those who donate to charitable nonprofit corporations really assume or prefer the existence of static fiduciary obedience norms; (2) the costs of a system requiring ex ante, substantive government approval of purpose/mission changes may outweigh the benefits of such a system, not only in fact, but also as perceived by donors; and (3) donors who desire to protect themselves against redirection of charitable donations can do so by restricting their charitable gifts.').

21 ibid 962.

22 Moreover, the definition of charity under state constitutional and statutory provisions relating to exemption from property tax is often more stringent than the requirements for federal income tax exemption. Sales tax exemptions, too, are often narrower than income tax exemptions.

23 See Evelyn Brody, 'All Charities Are Property-Tax Exempt, But Some Charities Are More Exempt than Others' (2010) 44 NE L REV 621, 672.

so ambiguous, broad, and overlapping, that resort to court is often still required, with differing consequences across the states (and sometimes within a state).

In some states, a constitutional issue implicating the separation of powers among the branches of government can arise if the legislature's views of 'charity' differ from the courts'. See my 2010 survey comparing, in their construction of similar state constitutional language, the absolutist approach of the Illinois Supreme Court with the apparent deference in Minnesota to a legislative compromise.[24] In 2012, echoing Illinois, the Pennsylvania Supreme Court declared that the legislature could curtail, but not enlarge, the Court's definition of the constitutional term 'institution of purely public charity'.[25] In states whose High Courts assert authority over constitutional terminology, real clarity or change requires an amendment to the state constitution. In June 2013 the Pennsylvania assembly approved an amendment to authorise the legislature to determine the qualifications for exemption for institutions of purely public charity; if the assembly approves such a proposed amendment in the next two-year session, it will be submitted to the electorate as a ballot referendum.

In 2012 the Illinois legislature addressed local threats to hospitals by requiring nonprofit hospitals to provide community benefit as a condition of property tax exemption, while broadly defining community benefit. Would the Illinois Supreme Court rule that this legislative effort fails to satisfy the judicially defined constitutional term 'charity'? Separately, the new statute does not address charities other than hospitals - so does the state's quid-pro-quo conception of exemption apply broadly, and does it include a requirement to provide free (or discounted) services to the poor? (And do churches and educational institutions need not worry because they enjoy exemption under specific categories in the constitution?) In 2011, an Illinois appellate court denying exemption to a retirement home commented: 'The amount of charity that it dispenses, $30,000, is far less than the property tax it would pay in the absence of an exemption, $160,501.43.'[26]

The Illinois appellate court in the case prompting legislation ominously illustrated the legal standard. While '"[c]harity," in law, is not confined *** to mere almsgiving,' the court declared:[27]

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24 ibid (comparing Provena Covenant Med Center v Dep't of Revenue 925 NE 2d 1131 (Ill. 2010) and Under the Rainbow Child Care Center Inc v County of Goodhue 741 NW 2d 880, 886 (Minn 2007)).

25 See Mesivtah Eitz Chaim of Bobov Inc v Pike County Board of Assessment Appeals 44 A.3d 3 (Pa 2012).

26 *Meridian Vill Ass'n v Hamer* 2011 Ill App. Unpub. LEXIS 222 (2011) (unpublished).

27 *Provena Covenant Med Ctr v Dep't of Rev* 894 NE 2d 452, 467-68 (Ill App 2008) (citations and internal quotations omitted).

> [c]harity is a gift, and one can give a gift to a rich person as well as to a poor person, the object being 'the improvement and promotion of the happiness of man.' For example, out of kindness and benevolence, one could build a water fountain in a park, and rich and poor alike could come and drink. But the designation of 'charity' would be problematic if the water fountain were coin-operated … For a gift (and, therefore, charity) to occur, something of value must be given for free.

Contrast a Massachusetts high court decision refusing to make free care a sine qua non of charitability, but rather treating it as one factor to consider.[28] The court added, however: 'The farther an organization's dominant purposes and methods are from traditionally charitable purposes and methods, the more significant these factors will be'.[29] The *New Habitat* court cleared up any implication from previous cases 'that the charging of a substantial fee, in itself, might render an organization not charitable under GLc 59, § 5, Third.' Finally, the court rejected an 'exceedingly difficult standard' proposed by the tax collector:[30]

> … whereby the charitable status of an organization depends on the wealth of its beneficiaries and the existence of sufficient alternative organizations that can perform the functions of the organization in question. This test … would require the court to delve into the personal finances of individual beneficiaries, determine the existence of comparable alternative organizations, and compare the quality and services of those organizations with the organization in question.

Tax Regulator as Charity Regulator

The public's legal responsibility for safeguarding charities and charitable assets typically falls on each state's attorney general. Many state charity officials can claim important successes in educating the public about fraudulent fundraising and challenging wrongdoing in solicitations for contributions; educating fiduciaries and staff in meeting their legal obligations and improving charity governance; rectifying self-dealing and other breaches of fiduciary duty by charity insiders; and assisting charities that have lost their way to restructure or dissolve. At the federal

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28 *New Habitat, Inc v Tax Collector of Cambridge* 889 NE 2d 414, 418-20 (Mass 2008) (citations omitted).

29 ibid 419. In adopting this approach, the court dropped a 'but see' citation to the Minnesota decision in *Under the Rainbow* (n 24). See also *New England Forestry Foundation v Board of Assessors of Town of Hawley* SJC-11432 (Mass 15 May 2014) in which the High Court ruled exempt land owned by a charitable conservation organisation and to which the public is permitted access; a heightened burden would apply had the public been denied access.

30 *New Habitat* (n 28) 422-23 (citations omitted).

level, through its administration of the requirements for tax exemption, the Internal Revenue Service also functions as a regulator - often the most influential regulator. However, while the IRS has recently emphasized sound charity governance, the federal tax regime lacks the broad range of equitable remedies available under state law.[31] To a large degree, legislatures and administrators, both state and federal, view sunlight as the best disinfectant, and are mandating increased nonprofit or tax exempt disclosures to enable charity constituents, 'peer regulators,' and even the media, charity watchdogs, and the general public to provide oversight.

Deficiencies in the American approach to charity supervision have occasionally led to calls for reform of the regulatory structure. From time to time proposals have emerged for a charity commission or similar body - looking to the English experience - to replace or supplement the charity oversight functions of the attorney general or Internal Revenue Service (or both). A Charity Commission model, however, while resolving some of the shortcomings of the attorney-general and judicial supervision model, creates problems of its own - notably the tension between being an advocate for and regulator of the charitable sector.

Role of attorney general in oversight and governance

While variations are found from state to state, most (but perhaps no more than two-thirds) of attorneys general enjoy common law authority for charity oversight tracing back to the Statute of Charitable Uses (Statute of Elizabeth) of 1601 (the *parens patriae* authority). However, common law enforcement power lacks the 'routine information-gathering and investigatory authority necessary to monitor the performance of charitable entities and initiate appropriate enforcement actions.'[32] Unless given enforcement authority by statute, moreover, the attorney general must go to court in order to obtain the necessary legal remedies.[33] In most states, the attorney general's *parens patriae* power is limited to the charitable subset of

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31 In 2004, echoing a Treasury Department proposal from 1969 focused on district-court jurisdiction, the Senate Finance Committee staff proposed that the US Tax Court should have equity powers over exempt organisations. Senate Finance Committee Staff Discussion Draft, *Tax Exempt Governance Proposals*, June 22, 2004, at 13, available at http://finance.senate.gov/imo/media/doc/062204stfdis.pdf

32 David Ormstedt, Michael Delucia, Daniel Moore, Karin Kunstler Goldman, Belinda Johns, Terry Knowles and Jody Wahl, 'Charitable Trusts and Solicitations' in Emily Myers and Lynne Ross (eds), *State Attorneys General: Powers And Responsibilities* (2nd edn, National Association Of Attorneys General, 2008).

33 See the Uniform Law Commission's Model Protection of Charitable Assets Act (2011). The Model Act contains provisions, among others, articulating the authority and powers of the attorney general to protect assets that have been dedicated to charitable purposes, whether held in trust or owned outright by charitable corporations. As of July 2014, this Model Act has been enacted only in Maryland and Hawaii, and has not been introduced in any other state.

nonprofit organisations, or in cases where the benefit from the enforcement action would be to the public and not to an identifiable group of private persons.[34] Finally, exceptions to the full panoply of enforcement actions might apply in the case of religious organisations.

The IRS as charity regulator

Congress sets charity policy primarily through the Internal Revenue Code. The role of the Internal Revenue Service with respect to charities is an anomaly within the agency, whose overall function is to ensure that taxpayers pay the taxes they owe. The IRS's supervision of tax exempt charities takes place in the Tax Exempt & Government Entities (TE/GE) Division, whose mission statement reads: 'To provide TE/GE customers top quality service by helping them understand and comply with applicable tax laws and to protect the public interest by applying the tax law with integrity and fairness to all'. As described on TE/GE's website: 'Governed by complex, highly specialized provisions of the tax law, this sector is not designed to generate revenue, but rather to ensure that the entities fulfill the policy goals that their tax exemption was designed to achieve'.[35] While Internal Revenue Code § 501(c) identifies 28 types of tax exempt organisations, the more than one million charitable organisations exempt under Code § 501(c)(3) account for about two-thirds of all recognised exempt organisations.

The IRS and state attorneys general have congruent but not identical objectives in overseeing charities: to facilitate legal compliance in order to preserve charitable assets. Importantly, although the IRS is a bureau of the Treasury Department, Congress has deliberately limited the influence of politics on the agency's operations. While the President controls policy decisions, taxpayer confidentiality protections require the IRS to conduct its enforcement activities without the involvement of Treasury, the White House, Congress, or other third parties. Thus, as a matter of structure, the IRS does not directly suffer from the pull of political considerations that may affect state attorneys general, who typically are

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34 The High Court of New York ruled that the New York Not-for-Profit-Corporation Law (N-PCL) preempted the state attorney general from suing an officer of a not-for-profit (but not charitable) corporation on four common law (non-statutory) causes of action. *People v Grasso* 893 NE 2d 105 (NY 2008) (suit against ousted chief executive Richard Grasso and former NYSE compensation committee chair Richard Langone arising out of asserted excessive compensation paid to Grasso). The Appellate Division then dismissed the two statutory claims, ruling that the attorney general lost authority once the NYSE merged into a for-profit corporation that would receive any recovery: 54 AD 3d 180 (NY App Div 2008).

35 http://www.irs.gov/uac/Tax-Exempt-&-Government-Entities-Division-At-a-Glance

elected officials.[36] As a matter of practice, though, the IRS cannot escape political pressures, as described below.

Substantively, Congress bases the requirements of Code § 501(c)(3) on the common law definition of charity, but then imposes additional conditions - notably the prohibition on political campaign activity and the limitations on lobbying. (See discussion below.) Those requirements could mean that a particular state-law charity is classified instead as a social welfare organisation exempt under Code § 501(c)(4) - or even as an organisation not entitled to federal tax exemption. In its gatekeeper function, the IRS determines whether an organisation filing an application for recognition of exemption under Code § 501(c)(3) or (c)(4) is organised and expected to operate appropriately. Thereafter, the IRS may at any time examine whether the charity operates within the constraints of the tax laws.

Congress's increased focus on governance in the business sector (culminating in the Sarbanes-Oxley Act of 2002) has led the IRS to intensify its focus on protecting tax exempt organisations from poor governance structures and practices. In its 2008 comprehensive report, a high-level advisory body 'acknowledge[d] the IRS's longstanding stake and legitimate interest in governance issues as they relate directly to compliance with the laws under its jurisdiction'. However, the report recommended that the IRS should approach its role with respect to nonprofit governance 'with caution' because the IRS 'is a powerful force that can drive behavior merely by asking about specific governance practices'.[37] Based on the infrequency of such intervention - despite the charges described next - the agency appears, if anything, overly reluctant to take aggressive action with respect to policing exempt-organisation misbehaviour.

The 501(c)(4) 'Tea Party Scandal' [38]

Many charities engage in advocacy activities as part of their charitable, educational, or religious purposes. The tax code does not use the term advocacy, but rather provides that a charity is not described in Code § 501(c)(3) if it engages in more than insubstantial lobbying or in any political campaign activity. Treasury

36 See generally Evelyn Brody, 'Whose Public?: Parochialism and Paternalism in State Charity Law Enforcement' (2004) 79 IND LJ 937.

37 Advisory Committee on Tax Exempt and Government Entities, *The Appropriate Role of the Internal Revenue Service with Respect to Tax-Exempt Organization Good Governance Issues* 1 (11 June 2008) available at www.irs.gov/pub/irs-tege/tege_act_rpt7.pdf

38 For more detailed background and analysis, see Donald B Tobin, 'The 2013 IRS Crisis: Where Do We Go From Here?' 142 TAX NOTES 1120 (10 March 2014). For comparison, see Ellen P Aprill, 'Nonprofits and Political Activity: Lessons from England and Canada' 142 TAX NOTES 1114 (10 March 2014).

Department Regulations explain:[39]

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

An 'action organization' - one that engages in substantial lobbying or in any political campaign activity, or whose purposes can be achieved only by a change in the law[40] - may instead qualify as a social welfare organisation exempt under Code § 501(c)(4).

Exemption under Code § 501(c)(4) requires the entity to operate primarily to further the common good and general welfare of the community, but not of a private group of citizens.[41] Because furthering the betterment of the common welfare under § 501(c)(4) includes advocating changes in the law, a social welfare organisation is not subject to the lobbying limitations that apply to § 501(c)(3) organisations. Separately, the Regulations provide: 'The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office'. However, the IRS has ruled that as long as a § 501(c)(4) organisation is 'primarily' engaged in activities that further its social welfare purposes, its exempt status will not be adversely affected by 'its lawful participation or intervention in political campaigns on behalf of or in opposition to candidates for public office' - although such political expenditures may be subject to tax under Code § 527.[42] (Even if permissible under federal tax law, such activity still must run the gauntlet of applicable federal and state election law.) Exemption under Code § 501(c)(4) status is less desirable than under (c)(3) because donations to (c)(4)s are not

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39 Treas Reg § 1.501(c)(3)-1(d)(2).

40 See Treas Reg § 1.501(c)(3)-1(c)(3). See *Slee v Commissioner* 42 F.2d 184 (2d Cir 1930) denying tax deductions for contributions to the American Birth Control League. While sustaining the trial court's determination that the League is organised for charitable purposes, Judge Learned Hand distinguished incidental lobbying activity from lobbying over broad issues of public policy: 'Political agitation as such is outside the statute, however innocent the aim … Controversies of that sort must be conducted without public subvention; the Treasury stands aside from them. Nevertheless, there are many charitable, literary and scientific ventures that as an incident to their success require changes in the law.' Ibid 185.

41 Treas Reg § 1.501(c)(4)-1(a)(2).

42 Revenue Ruling 81-95, 1981-1 CUM BULL 332.

eligible for the charitable contribution deduction.[43] Moreover, to prevent tax-deducted contributions from being used for impermissible lobbying or politics, a (c)(3) that loses exemption for these activities is not eligible for (c)(4) status.

Congress generally enjoys broad latitude in designing tax regimes, including conditions placed on tax exemptions. The 'doctrine of unconstitutional conditions' is narrowly applied in the tax exemption context: The Supreme Court upheld Congress's authority to prohibit a charity, as a condition of § 501(c)(3) tax exemption, from engaging in more than insubstantial lobbying.[44] In reaching this holding, however, the Court relied in part on the right of the (c)(3) to create an affiliated (c)(4) to exercise the group's right to speak on issues before legislatures. As a result, the charity's advocacy (and permitted level of lobbying) could be supported by tax-deductible charitable contributions, but the affiliated (c)(4)s lobbying and permitted level of political activity would be funded by after-tax dollars. Similarly, a (c)(4) whose primary activity would be political could instead establish a separate political action committee exempt under § 527. Critically, although political contributions are not deductible either, election law generally requires the § 527 to disclose the identities of its donors.

In 2010, the Supreme Court struck down a federal election statute that prohibited corporations - for-profit as well as nonprofit - from engaging in unlimited independent expenditures on behalf of or in opposition to candidates for public office. *Citizens United v Federal Election Commission*,[45] however, focused on the First Amendment constitutional right to free speech, and did not address the requirements for federal tax exempt status. While scholars generally assume that Congress could continue to prohibit (c)(3)s from engaging in politics, political strategists found an opportunity to exploit the (c)(4) regulations, which were written for an era that did not contemplate unconstrained corporate political activity. Significantly, unlike § 527 political organisations, organisations exempt under § 501(c) do not have to disclose their donors to the public.[46] The Center for Responsive Politics found that independent expenditures from non-publicly-

43 See Internal Revenue Code § 170.

44 Regan v Taxation With Representation 461 US 540 (1983).

45 558 US 310, 370 (2010).

46 The Forms 990 require the exemption organisation to disclose on Schedule B the identities of any donor of at least $5,000, but this list (except for private foundation and § 527 organisations) is redacted from public disclosure. Ways and Means Committee Chairman (and Republican) Dave Camp's 26 February 2014 tax-reform proposal would require a (c)(4) to list $5,000 gifts only if made by an officer, director, or 'covered employee' (generally, one of the five most highly compensated employees). See description of Bill, § 6003 at:
http://waysandmeans.house.gov/uploadedfiles/ways_and_means_section_by_section_summary_final_022614.pdf

disclosed sources in the 2012 presidential election cycle exceeded $310 million, a startling increase from the $69 million recorded in the 2008 cycle.

To the ultimate chagrin of the IRS, this repurposed use of (c)(4) status prompted thousands of new organisations - most conservative, many small and unsophisticated, and some named 'Tea Party' - to apply for recognition of exemption from the IRS's Exempt Organization's division. (Ironically, only (c)(3) status requires advance IRS approval, while other types of exempt organisations - including the well-advised and larger new (c)(4)s - can simply 'self declare' and file the annual Form 990.[47]) Sensibly, the understaffed IRS responded to this flood of novel and often incomplete (c)(4) applications by focusing attention on the questionable ones. Inevitably, though, the IRS's scrutiny drew out the process, and the agency opened itself up to charges of political bias by inappropriately using 'Be On the Lookout' (BOLO) lists that included, among other screens, organisations with certain terms in their names (including 'Tea Party,' '9/12,' and 'Patriot' - and, it later transpired, 'Progressive,' 'Occupy,' and 'Israel'[48]). It should be noted that screening does not necessarily translate into denial.[49]

Making life difficult for vocal organisations skeptical of federal power in general and the incumbent President's party in particular, however, was not a wise strategy for the IRS. Several applicants found a sympathetic ear in the Republican chair of the House Oversight and Government Reform Committee,[50] who asked the Treasury Inspector General for Tax Administration to investigate whether

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47 Camp's tax-reform proposal, ibid § 6001, would require a new (c)(4) to at least notify the IRS of its claimed status and to file an enhanced Form 990 for its first year of operations. Section 6002 of the proposal would extend to a (c)(4) applicant the right currently limited to an applicant for (c)(3) status for a judicial declaratory judgment of entitlement to exemption.

48 See redacted lists from 2010 available on the Ways and Means Committee minority's site at http://democrats.waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/November%202010%20BOLO%20IRS0000001349-IRS0000001364.pdf

49 See the leaked 2011 table prepared by IRS EO Technical, posted by USA Today on 17 September 2013 at: http://s3.documentcloud.org/documents/789861/usa-today-irs-political-advocacy-case-list.pdf

50 See Fact Sheet: Lois Lerner and the Oversight Committee Investigation of the IRS Targeting Scandal (4 March 2014) ('The Committee's investigation began in February 2012, after concerns about disparate treatment and inappropriate scrutiny of applicants for tax exempt status by the IRS were brought to the Committee's attention. The underlying concerns were IRS efforts to deny Americans their right to free political speech because of their beliefs … ') available at http://oversight.house.gov/release/fact-sheet-lois-lerner-oversight-committee-investigation-irs-targeting-scandal/

conservative groups were being 'targeted' for special scrutiny. When you put the question that way, guess what his report, issued a year later, found?[51]

Space constraints do not permit further coverage of the unhappy events that followed for the IRS in the last year; nor do I want to defend the IRS's management of these cases. Many heads rolled, including those of the Acting Commissioner of Internal Revenue, the director of the Exempt Organizations Division, and the Director of EO Rulings and Agreements. The interim IRS Commissioner and new management cleared out the backlog of applicants by offering an expedited process of (c)(4) exemption for applicants willing to certify that they would spend no more than 40 per cent of their expenditures and time on political activities.[52] The irony-free critics of the IRS simultaneously believe that these organisations did not violate the requirements of 501(c)(4) and that dilatory actions by Democratic partisans in the agency (perhaps on orders from the White House) cost Mitt Romney the presidency in 2012.

I do wish to emphasize, though, that the spooked staff of the IRS - a tax-collection agency, not a political-regulatory body - lacks clear, updated guidance to carry out its thankless job.[53] Specifically, new regulations (or, better still, a legislative fix, perhaps shifting more responsibility to the Federal Election Commission) are needed for a post-*Citizens United* world. In November 2013, the Treasury Department and IRS proposed regulations on what constitutes political (as distinct from 'social welfare') activities by § 501(c)(4) organisations. The proposed regulations would have replaced the current reference to 'direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office' with the new term 'candidate-related political activity.' The new, broad concept embraces communications expressly advocating for a clearly identified political candidate (or communications made within 60 days of a general election, or within 30 days of a primary election, that identify a candidate or political party), as well as contributions to or distributions of material on behalf of a candidate, a § 527 political organisation, or a § 501(c) organisation engaging in candidate-related political activity. To the surprise and distress of many, including some organisations on the 'left,' the category also included

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51 Report, Treasury Inspector General For Tax Administration, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review,* 14 May 2013, available at:

http://www.treasury.gov/tigta/auditreports/2013reports/201310053fr.pdf

52 See http://www.irs.gov/Charities-&-Non-Profits/New-Review-Process-and-Expedited-Self-Certification-Option

53 On 21 February 2014, the IRS posted to its website sample questions that an applicant might receive on the subject at http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Exempt-Organization-Sample-Questions-Attempting-to-Influence-Legislation-or-Political-Campaign-Intervention-Activities

several activities generally permitted even to § 501(c)(3) charities,[54] notably engaging in a voter registration drive or 'get-out-the-vote' drive; preparing or distributing a voter guide that refers to one or more clearly identified candidates; and hosting or conducting a forum for candidates within 30 days of a primary election or 60 days of a general election.[55]

At the same time, the proposed regulations did not address many important issues, on which the agency requested comments: What proportion of non-social-welfare activities is too much for (c)(4) status? What other specific activities, if any, should be included in the definition of candidate-related political activity? Should the same or similar rules be applied to 501(c)(3) charities, 501(c)(5) labor unions, and 501(c)(6) trade associations,[56] as well as to 527 political organisations? By the February 2014 end of the comment period, the IRS had received more public input than on any other proposed regulation in the agency's history,[57] over 160,000 comments.[58] Even noted cable-television satirist Stephen Colbert - whose segments involving his SuperPAC won him a Peabody Award for journalism for exposing the use and abuse of 'dark money' in politics - asked to testify at the IRS hearing on the proposed regulation.[59] On 22 May 22 2014, the IRS announced the

54 See also Preamble to Prop Treas Reg § 1.501(c)(4)-1, 78 Fed Reg 230 (2013) ('The Treasury Department and the IRS note that defining 'candidate-related political activity' in these proposed regulations to include activities related to candidates for a broader range of offices (such as activities relating to the appointment or confirmation of executive branch officials and judicial nominees) is a change from the historical application in the section 501(c)(4) context of the section 501(c)(3) standard of political campaign intervention, which focuses on candidates for elective public office only.').

55 Prop Treas Reg § 1.501(c)(4)-1(a)(2)(iii)(A).

56 See e.g. Michael Beckel, *Major US Companies Quietly Funnel Dark Money to Politically Active Nonprofits,* Center for Public Integrity, 16 January 2014.

57 Fred Stokeld *et al*, 'IRS Hearing on EO Guidance Expected in Spring' 142 TAX NOTES 1078 (10 March 2014) (quoting the IRS deputy commissioner for services and enforcement). Most comments were very brief, and many - pro and con - nearly identical.

58 The regulation and the comments are posted online under the heading 'Guidance for Tax-Exempt Social Welfare Organizations on Candidate-Related Political Activities (REG-134417-13)' available at http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-0001

59 See the letter and analysis at Paul Blumenthal, *Stephen Colbert to IRS: Let Me Make Fun of 'Dark Money' and Super PACs Some More*, HUFFINGTON POST, 28 February 2014, available at: http://www.huffingtonpost.com/2014/02/28/stephen-colbert-super-pac_n_4876914.html. Colbert's website for this activity is at: http://www.colbertsuperpac.com/home.php

withdrawal of the proposed regulations, which it plans on re-proposing after taking the public's comments into account.[60]

A hardened sense of grievance, impervious to facts of even-handed 'targeting' - and a conflation of constitutional protection of speech with entitlement to tax exemption - continue to permeate the conservative press on this issue.[61] (To a much less degree, the left has also used incendiary language.)

In February 2014, IRS Commissioner John Koskinen estimated that the agency had spent almost $8 million in direct costs for 225 employees who devoted 97,542 hours responding to congressional investigations; an additional $6-$8 million for information-technology upgrades to securely and efficiently process materials for investigators; plus (unestimated) 'ancillary support costs' incurred by administrative offices. Several congressional Democrats, who had asked the IRS Commissioner for this information, charged:[62]

> Through the course of the nine-month investigations, the IRS has produced more than 500,000 pages of documents and made available 35 former and current IRS employees for interviews. Treasury and IRS officials have testified on the topic at 15 congressional hearings. And yet, there is zero evidence of any political motivation or outside involvement.

In July, reports that hard drive crashes at the IRS made irretrievable swathes of emails stored on the computers of Lois Lerner and others breathed new life into congressional investigations. Brought back before Congress, Koskinen updated these numbers:[63] 'To date we have produced more than 960,000 pages of

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60 See http://www.irs.gov/uac/Newsroom/IRS-Update-on-the-Proposed-New-Regulation-on-501(c)(4)-Organizations

61 See Paul Caron's running TaxProf blog posts of links titled 'The IRS Scandal, Day XXX,' in which the conservative postings far outnumber those from the left or even mainstream media. For example, 'Day 345,' available at:

http://taxprof.typepad.com/taxprof_blog/2014/04/the-irs-scandal-16.html, links to such headlines as 'The IRS's Torrent of Abuses' (*Town Hall*) and 'IRS 'Wants to Throw Us in Jail,' Says Tea Party Leader' (*Washington Times*) as well as the *Tampa Bay Times*' 'PunditFact' analysis 'Is the IRS Obama's Watergate?' (concluding no).

62 Press Release, Republican IRS Investigations Have Cost at Least $14 Million - And Counting (26 February 2014) available at http://democrats.oversight.house.gov/press-releases/republican-irs-investigations-have-cost-at-least-14-million-and-counting/, contains a link (at: http://democrats.oversight.house.gov/uploads/2%2025%20Cummings%20Response.pdf) to the IRS Commissioner's 25 February 2014 response.

63 Written Testimony of John A Koskinen, Commissioner Internal Revenue Service, Before the House Oversight and Government Reform Committee, Subcommittee on Economic Growth, Job Creation and Regulatory Affairs (23 July 2014) 4, available at http://oversight.house.gov/wp-content/uploads/2014/07/Koskinen-IRS-Final.pdf

unredacted documents to the tax-writing committees … and more than 700,000 pages of redacted documents to the House Oversight and Government Reform Committee and the Senate Permanent Subcommittee on Investigations.' In addition: 'More than 250 IRS employees have spent more than 125,000 hours working directly on complying with the investigations, at a cost of approximately $10.75 million'.

Long-term consequences to the IRS

So what is the future of the IRS's exempt-organisation function, and can the agency coat this irritant with sufficient nacre to save itself? On 20 March 2014, the IRS issued a statement describing a 'realignment' of the Tax Exempt & Government Entities (TE/GE) division that shifts its technical legal staff to the IRS's Office of Chief Counsel and moves the head of the EO Division from Washington, D.C., to the Cincinnati office, which processes most of the 60,000 applications for tax exemption received each year.[64] (Note that the IRS expects this number to drop as much as 70 percent with its newly available Form 1023-EZ,[65] discussed below.) The transfer to Counsel of TE/GE guidance functions (issuance of revenue rulings, revenue procedures, technical advice memoranda, and some private letter rulings) conforms to changes the agency made years ago for other functions. However, the exile of the EO Division director, while perhaps aiding processing of the perennially lengthy approval process, could make coordination between the field and headquarters more difficult. Former EO Division director Marcus Owens asks whether the new arrangement 'will facilitate the surfacing of issues … of critical importance beyond the tax system or that otherwise have huge significance for tax administration' - and 'whether that will be done in a transparent way in which the legal analysis is shared with everyone'.[66]

The week before the 15 April 2014 tax-filing deadline, two party-line votes by the Republican-dominated House committees asserted criminal behaviour by former EO Division director Lois Lerner. First, the Ways and Means Committee asked the Justice Department to pursue criminal charges for, among other things, her

64 The IRS has not posted an official version of the statement, but it can be found electronically in LEXIS's Fedtax Library (Tax Notes Today file) at 2014 TNT 55-15, *IRS Announces Realignment of Some Legal Resources in TE/GE*, 20 March 2014.

65 See http://www.irs.gov/uac/Newsroom/New-1023-EZ-Form-Makes-Applying-for-501c3 Tax- Exempt-Status-Easier-Most-Charities-Qualify

66 William R Davis and Fred Stokeld, 'IRS Announces Shake-Ups in TE/GE and Chief Counsel's Office' TAX NOTES1308 (24 March 2014).

handling of the (c)(4) exemption application of Karl Rove's Crossroads GPS;[67] the Democrats complained that this information could have been conveyed to the Justice Department without publicly disclosing taxpayer information[68] (applicants' identities are confidential until exemption is granted, if ever). The next day, the Government Oversight and Reform Committee held Lerner in contempt of Congress despite her asserting her Fifth Amendment right not to answer the committee's questions;[69] on 7 May 2014, by a vote of 231-187 (with six Democrats joining all the Republicans), the full House approved the criminal contempt charge.[70] Professor Lloyd Hitoshi Mayer observed that the fact that Republicans 'are now focusing their accusations on a single, IRS career civil servant strongly suggests that they have failed to find any evidence to support accusing higher officials with wrongdoing despite investigating the exemption application mess for almost a full year'.[71]

Paul Streckfus, the editor of a publication on exempt-organisation issues, recently commented in a panel discussion:[72]

> Unfortunately, Congress (primarily House Republicans) have spent the last eleven months trying to pin the [the IRS's] EO problems on one or more individuals, rather than looking at the many problems that go way beyond inappropriate handling of Tea Party applications, which, while a serious

67 Ways and Means Committee Refers Lois Lerner to Department of Justice for Criminal Prosecution (9 April 2014) at:

http://waysandmeans.house.gov/news/documentsingle.aspx?DocumentID=375999

68 See http://democrats.waysandmeans.house.gov/press-release/statement-wm-democrats-opposing-referral-letter-justice-department

69 See http://oversight.house.gov/release/oversight-committee-approves-lois-lerner-contempt-congress-resolution/ (10 April 2014). For the minority's objections, see http://democrats.oversight.house.gov/press-releases/rapid-response-issa-blocks-cummings-request-to-release-irs-interview-transcripts/

70 See http://congress.gov/bill/113th-congress/house-resolution/574

71 As quoted in Katie Sanders, *Is the IRS Controversy President Barack Obama's Watergate?* available at http://www.politifact.com/punditfact/article/2014/apr/18/is-the-irs-scandal-the-next-watergate/

72 From the Desk of Paul Streckfus, Editor, *EO Tax Journal*, Email Update 2014-79 (18 April 2014) *DC Bar Panel Discussed EO Division Reorganization*. See also George Yin's proposal - both to enhance public trust and to counter allegations of wrongdoing by the IRS - by removing the confidentiality protections for exemption applications and materials as soon as they are filed with the IRS and relaxing those protections for audit developments, closing agreements, and final determinations. George K. Yin, *In Reforming (and Saving) the IRS by Respecting the Public's Right to Know*, __ VIRGINIA LAW REVIEW __ (forthcoming); a shorter version, under the title *Saving the IRS*, is available in 143 TAX NOTES 589 (5 May 2014).

> problem, is but a tiny piece of the puzzle of why the EO functions are so dysfunctional.

He recommends, among other improvements, that policy makers 'determine whether EO has sufficient employees to run an effective review of new applications for exemption; if not, seriously consider self-certification, backed up by examinations'.[73]

As to 'self-certification,' on 1 July 2014, the IRS finalized a new Form 1023-EZ, proposed in April.[74] Without requiring supporting information, the three-page form requires the applicant to 'attest' that it is organised and operated exclusively to further one or more exempt charitable purposes; and that it will satisfy the basic requirements set out in the statute and regulations, including:

- Refrain from supporting or opposing candidates in political campaigns in any way.
- Ensure that your net earnings do not inure in whole or in part to the benefit of private shareholders or individuals (that is, board members, officers, key management employees, or other insiders).
- Not further non-exempt purposes (such as purposes that benefit private interests) more than insubstantially.
- Not be organised or operated for the primary purpose of conducting a trade or business that is not related to your exempt purpose(s).
- Not devote more than an insubstantial part of your activities attempting to influence legislation …

In response to heavy opposition to the proposed version of the Form 1023-EZ, the IRS reduced the filing threshold: Applicants must have assets of $250,000 or less (originally $500,000 or less) and annual gross receipts of $50,000 or less (originally $200,000 or less).[75] Initial observations suggest that the IRS is meeting

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73 ibid.

74 This form, which can be filed only electronically, is available at http://www.irs.gov/pub/irs-pdf/f1023ez.pdf. For the 1 July 2014 press release, see http://www.irs.gov/uac/Newsroom/New-1023-EZ-Form-Makes-Applying-for-501c3Tax-Exempt-Status-Easier-Most-Charities-Qualify; and for detailed explanation of the requirements (particularly pp 4-5, describing the ineligible organisations) see http://www.irs.gov/pub/irs-drop/rp-14-40.pdf

75 The proposed thresholds matched the eligibility levels for filing the simplified annual information return, Form 990-EZ; the new gross-receipts threshold matches the eligibility level for filing the even simpler Form 990-N (the 'e-Postcard').

its goal to streamline the exemption process,[76] but the IRS's traditional gate-keeper function has nipped in the bud many unworthy would-be exempt organisations.[77] Both the charitable sector[78] and state charity regulators[79] have raised concerns about the ability of the IRS to exercise oversight of 'small' exempt organisations through post-exemption examinations by its Review of Operations Unit.[80]

Commissioner Koskinen responds with three points. First, electronic filing of the Form 1023-EZ will allow the IRS to more easily screen questionable applications. Second, the agency will test a statistical sampling of the applications 'and put them through the more rigorous process, to see if they've answered the questions correctly, or whether … if they'd gone through the 26-page questionnaire, [they] would have been not qualified, … and see how accurate is the short form'. Finally, the IRS will 'take another statistical sample, once they're out a year, and go out and audit how they're doing and what are they doing'.[81]

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76 Ofer Lion and Douglas Mancino, *Practitioner's Guide to the New IRS Form 1023-EZ: Critical Considerations* (Hunton & Williams Client Alert, July 2014) ('early returns indicate that determination letters are being issued to Form 1023-EZ filers in two or three weeks' time') available at http://www.hunton.com/files/News/fd614dd0-028e-43bc-b436-9cf6ef71fa6e/Presentation/NewsAttachment/c38c57ab-08ab-4dd8-9cdd-9d645037f9cd/Practitioners_Guide_to_the_New_IRS_Form_1023_EZ_Critical_Considerations.pdf

77 See e.g. Determination Letter 201430014 (30 April 2014) available at http://www.irs.gov/pub/irs-wd/201430014.pdf (denying exemption to an organisation whose stated purpose is the 'protection of the human rights of defenseless victims from involuntary microwave and M attack, organised stalking, or direct mind control attack of its various forms, and to compensate such targets from (SIC) the associated damage or death resulting from such sightings').

78 See Massimo Calabresi, 'IRS to Rubber-Stamp Tax-Exempt Status for Most Charities After Scandal' TIME, 13 July 2014 (subtitled IRS head touts 'efficiencies,' but some groups fear fraud) available at http://time.com/2979612/irs-scandal-tax-exempt-tea-party-political-groups-john-koskinen/

79 See comments on the proposed form by the National Association of Attorneys General/National Association of State Charities Officials (30 April 2014): http://www.nasconet.org/wp-content/uploads/2014/05/FINAL-NASCO-comments-re-Form-1023-EZ1.pdf

80 Brad Bedingfield, 'Blame It on the ROO: Form 1023-EZ and Decline of EO Determinations' TAX NOTES, 14 July 14 2014, 184, available at http://www.taxanalysts.com/www/features.nsf/Features/83896E3877EA2C0985257D150067C166?OpenDocument

81 William Hoffman, *Tax Analysts Exclusive: Conversations: John Koskinen* (29 July 2014) in LEXIS, FedTax Library, 2014 TNT 147-2 (31 July 2014), available at: http://www.taxanalysts.com/www/features.nsf/Articles/6BE36D73F5F1AB3385257D26004D216E?OpenDocument

Conclusion

No clarity will come soon, if ever, to the law that applies to US corporate charities seeking to alter their charitable purposes. Nor will the debate subside over which charities - even if income tax exempt - can claim property tax exemption. As to the troubling developments of oversight, the January 2015 program of the Nonprofit and Philanthropy Law Section of the Association of American Law Schools will consider 'IRS Oversight of Charitable and Other Exempt Organizations - Broken? Fixable?' Nor, as is illustrated by the other articles from this symposium, is the United States unique in struggling with the appropriate regulatory regime for charities.[82] A 2015 symposium at the Chicago-Kent Law Review will examine ongoing challenges worldwide to the legitimacy of governmental oversight of charitable activity.

82 See e.g. Fiona Martin's article in this issue of CL&PR; F Martin, 'Developments in Australian Charity Law: One Step Forward and Two Steps Backward' (2014-15) 17 CL&PR 23.