

“THE BETTER PART OF VALOUR IS DISCRETION”: SHOULD THE IRS CHANGE OR SURRENDER ITS OVERSIGHT OF TAX-EXEMPT ORGANIZATIONS?

Lloyd Hitoshi Mayer*

Abstract

Recent events have highlighted the difficulties the Internal Revenue Service faces when attempting to ensure that purportedly tax-exempt organizations in fact qualify for that status. The problems in this area go much deeper than a group of IRS employees subjecting certain organizations to greater scrutiny based on their political leanings, however. For decades members of the public, the media, the academy, and Congress have criticized the limited ability of the IRS to ensure that organizations claiming exemption from federal income tax in fact deserve that categorization. Yet examples of IRS failings in this area continue to arise with depressing frequency. This is not surprising given that oversight of exempt organizations is but one of many areas that suffers from major difficulties faced by the IRS as a whole, including shrinking resources, growing responsibilities, and increasing responsibility for determinations that go beyond those necessary for revenue collection. This Article draws on tax compliance literature to explore how the current level and methods of oversight for exempt organizations could be modified to improve compliance even given the existing resource constraints. It concludes that while marginal improvements in oversight are possible, there is no silver bullet to counter the IRS’s growing inability to oversee this area. Part IV of this Article therefore turns to more radical proposals that would move the locus of oversight for exempt and particularly charitable organizations out of the IRS. The proposal that shows the most promise, but also is the most risky, would shift much of this role to a private, self-regulatory body overseen by the IRS. Given the current state of IRS oversight, this proposal deserves serious consideration.

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I. INTRODUCTION

Recent events have highlighted the difficulties the Internal Revenue Service (IRS) faces when attempting to ensure that purportedly tax-exempt organizations do in fact qualify for that status.¹ These problems go much deeper than a group of IRS employees subjecting certain organizations to greater scrutiny based on their political leanings. For decades, members of the public, the media, the academy, and Congress have criticized the limited ability of the IRS to ensure that organizations claiming exemption from federal income tax in fact deserve that categorization.² Yet examples of IRS failings in this area continue to arise with depressing frequency despite numerous suggestions for improvement and various congressional and agency initiatives.³ This is consistent with the major difficulties faced by the IRS as a whole and discussed by other presenters at this symposium.⁴ As detailed in Part II of this Article, these difficulties have rendered the IRS unable to keep pace with the growth of the exempt organizations sector over the past 40 years.

One of the latest such initiatives suggests a new approach, however. In 2014, the IRS introduced the much shorter and simpler Form 1023-EZ application for nonprofit organizations that claim exempt charitable status and expect to have only modest financial resources, accompanied by faster procedures for handling all applications for recognition of exemption.⁵ These innovations represent the first significant, permanent reduction in the level of oversight the IRS provides in this area since the introduction of the Form 990-EZ, a shorter version of the annual information return required for most exempt organizations.⁶ It is arguable, however, whether a reduction of oversight is in fact prudent and whether other reductions might also be advisable. Part III of this Article draws on tax compliance literature to explore how the current level and methods of oversight for exempt organizations could be modified to improve compliance given existing resource constraints. It concludes that while marginal improvements in oversight are possible, there is no silver bullet to counter the IRS's growing inability to oversee this area.

Part IV of this Article therefore turns to more radical proposals that would move the locus of oversight for exempt and particularly charitable organizations out of the IRS. The proposal that shows the most promise, but also is the most risky, would shift much of this role to a private, self-regulatory body overseen by the IRS. The current crisis, however, highlights the need to pursue this proposal now.

II. A BRIEF HISTORY OF IRS OVERSIGHT

In theory, oversight of exempt organizations by the IRS and its predecessors is as old as the Internal Revenue Code itself.⁷ In practice, there appears to have been little actual oversight until Congress began requiring an annual information return for some exempt

¹ See S. REP. NO. 114-119, at 60 (2015); Lily Kahng, *The IRS Tea Party Controversy and Administrative Discretion*, 42 CORNELL L. REV. ONLINE 41, 42-44, 49-51 (2013); Paul Caron, *The IRS Scandal*, TAXPROF BLOG, http://taxprof.typepad.com/taxprof_blog/irs-scandal [<http://perma.cc/FS8W-7T8H>].

² See *infra* Part III.A.

³ *Id.*

⁴ See Memorandum from J. Russell George, Inspector General, Dep't of the Treasury, to Jacob Lew, Sec'y of the Treasury 1-2 (Oct. 15, 2014), https://www.treasury.gov/tigta/management/management_fy2015.pdf [<https://perma.cc/WMP4-GXHG>].

⁵ See FORM 1023-EZ, STREAMLINED APPLICATION FOR RECOGNITION OF EXEMPTION UNDER SECTION 501(C)(3) OF THE INTERNAL REVENUE CODE, <http://www.irs.gov/uac/About-Form-1023EZ> [<http://perma.cc/23VW-QGJR>].

⁶ See IRS Announcement 89-34, 1989-10 I.R.B. 30.

⁷ See Act of Oct. 3, 1913, Pub. L. No. 63-16, § 2(G)(a), 38 Stat. 114, 172 (1913).

organizations effective as of 1943.⁸ Furthermore, Congress did not require that any organizations apply to the IRS for recognition of their exempt status until it imposed this requirement on many charitable organizations in 1969.⁹

This Part describes these two main channels for IRS oversight of exempt organizations: consideration of applications for recognition of exemption and examinations of annual information returns. It also reviews the other significant exempt organization related activities engaged in by the IRS, such as providing various forms of guidance, rulings, and technical advice, and the limited evidence regarding the current level of compliance by exempt organizations with the applicable federal tax laws. First, it is useful to consider both the extent to which the size of the regulated community has grown over time and the resources the IRS directs to overseeing this community, which have not kept pace.

A. Exempt Organizations and the IRS Exempt Organizations Division

The following two tables show the IRS-reported numbers and aggregate assets and revenues for exempt organizations, both generally and specifically for charitable (I.R.C. § 501(c)(3)) organizations and the most numerous non-charitable organizations (I.R.C. § 501(c)(4) social welfare organizations; I.R.C. § 501(c)(5) labor, agricultural, and horticultural organizations; I.R.C. § 501(c)(6) business leagues, chambers of commerce, and similar entities; I.R.C. § 501(c)(7) social and recreational clubs; and I.R.C. § 501(c)(8) fraternal beneficiary organizations).

⁸ See Revenue Act of 1943, Pub. L. No. 78-285, § 117, 58 Stat. 21, 36-37 (1944); H.R. REP. NO. 78-871, at 24-25 (1943); S. REP. NO. 78-627, at 21 (1943). The Treasury Department imposed an annual information return requirement in 1942 on certain exempt organizations, effective for tax year 1941, although it was not clear it had the authority to do so. See T.D. 5125, 1942-1 C.B. 101 (codified at Treas. Reg. 103, § 19.101-1), as modified by T.D. 5177, 1942-2 C.B. 123; MARION R. FREMONT-SMITH, GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION 65 (2004).

⁹ See Tax Reform Act of 1969, Pub. L. No. 91-172, § 101(a), 83 Stat. 487, 494-96 (1969) (codified at I.R.C. § 508); H.R. REP. NO. 91-431, pt. 1, at 37 (1969); S. REP. NO. 91-552, at 53 (1969). Treasury by regulation provided an application process before 1969, but it is not clear if Treasury sought to make this process mandatory. See, e.g., T.D. 2693, 20 Treas. Dec. Int. Rev. 293 (1918); T.D. 5125, 1942-1 C.B. 101 (codified at Treas. Reg. 103, § 19.101-1); Philip Hackney, *Should the IRS Never "Target" Taxpayers? An Examination of the IRS Tea Party Affair*, 49 VAL. U. L. REV. 453, 460-61 (2015).

Table 1: Exempt Organizations: Numbers¹⁰

Fiscal Year	All 501(c)s	501(c)(3)s	501(c)(4)-(8)s	Other 501(c)s
1980	846,433	319,842	453,415	73,176
1985	854,806	366,071	412,877	75,858
1990	1,022,214	489,882	443,066	89,266
1995	1,162,810	626,226	439,424	97,160
2000	1,354,395	819,008	431,965	103,422
2005	1,570,023	1,045,979	421,410	102,634
2010	1,821,824	1,280,739	437,581	103,504
2011	1,494,882	1,080,130	330,336	84,416
2012	1,484,818	1,081,891	320,029	82,898
2013	1,442,197	1,052,495	310,126	79,576
2014	1,568,454	1,117,941	369,416 ¹¹	81,097

¹⁰ See IRS 1980 ANN. REP. 76; IRS 1986 ANN. REP. 60; IRS ANN. REP. 1990, at 38; IRS DATA BOOK 1995, at 25; IRS DATA BOOK 2000, at 24; IRS DATA BOOK 2005, at 40; IRS DATA BOOK 2010, at 56; IRS DATA BOOK 2011, at 56; IRS DATA BOOK 2012, at 56; IRS DATA BOOK 2013, at 56; IRS DATA BOOK 2014, at 58.

¹¹ The sharp increase from fiscal year 2013 to fiscal year 2014 for I.R.C. § 501(c)(4)-(8) organizations is almost entirely attributable to a dramatic increase in the number of reported I.R.C. § 501(c)(4) organizations. Compare IRS DATA BOOK 2013, at 56 (91,056 such organizations), with IRS DATA BOOK 2014, at 58 (148,585 such organizations). In response to an inquiry, the IRS stated its preliminary conclusion is that this increase represents “entities that have applied for an [Employer Identification Number] as an exempt organization (EO) but have not yet filed a Form 1023 or 1024 and obtained an EO determination” (and so are not necessarily claiming exemption under I.R.C. § 501(c)(4)). E-mail from Emily Gross, IRS Statistics of Income Division (Aug. 31, 2015, 3:22 p.m. EDT) (on file with author).

Table 2: Exempt Organizations: Finances¹² (millions of dollars)

Fiscal Year	501(c)(3) Assets	501(c)(4)-(8) Assets	501(c)(3) Revenues	501(c)(4)-(8) Revenues
1995	1,143,079	159,344	663,371	81,415
2000	1,562,536	217,068	866,208	109,350
2005	2,241,887	282,862	1,252,889	153,688
2010	2,946,521	342,898	1,593,011	176,623
2011	3,030,133	359,926	1,647,905	179,300

The numbers reproduced in the first table above appear to exclude I.R.C. § 501(c) organizations that are not required to apply for IRS recognition of their exempt status and have not chosen to voluntarily do so.¹³ Organizations not required to apply include churches, certain church-related entities, very small organizations (less than \$5,000 in annual gross receipts), and all non-501(c)(3) entities.¹⁴ A study by the Urban Institute estimates that churches currently number approximately 300,000 and very small organizations number approximately 400,000.¹⁵ These figures also do not include several other, relatively small in terms of numbers and financial resources, types of exempt organizations that fell within the jurisdiction of the IRS Exempt Organizations Division during some or all of this period, nor do they include a small subset of taxable entities (primarily non-exempt trusts) that also fell within that division's jurisdiction during this period.¹⁶

Similarly, the financial figures do not include organizations that are not required to file annual information returns, including churches, certain church-related entities, and organizations with annual gross receipts below certain thresholds (which thresholds have varied over time).¹⁷ The financial figures for I.R.C. § 501(c)(3) organizations also do not include financial information for private foundations, which the IRS reports separately. Those figures also reflect a growth in numbers and financial resources over the same time

¹² Cecelia Hilgert & Melissa Whitten, *Charities and Other Tax-Exempt Organizations, 1995*, STAT. INC. BULL. 105, 123-25 (Winter 1998-1999); Paul Arnsberger, *Charities and Other Tax-Exempt Organizations, 2000*, STAT. INC. BULL. 122, 134-36 (Fall 2003); Paul Arnsberger, *Charities, Labor and Agricultural, and Other Tax-Exempt Organizations, 2005*, STAT. INC. BULL. 271, 281-82 (Fall 2008); Paul Arnsberger, *Nonprofit Charitable Organizations, 2010*, STAT. INC. BULL. 74, 85, 87 (Winter 2014); Paul Arnsberger, *Nonprofit Charitable Organizations, 2011*, STAT. INC. BULL. 1, 10, 12 (Spring 2015) [hereinafter *Charitable Organizations 2011*]. These sources rely on a sample of annual information returns for each fiscal year. See, e.g., *Charitable Organizations 2011*, at 4.

¹³ See IRS DATA BOOK 2014, at 58 n.1.

¹⁴ See I.R.C. § 6033(c)(1) (2014).

¹⁵ See KATIE L. ROEGER ET AL., THE NONPROFIT ALMANAC 2012, at 2 n.1 (2012).

¹⁶ For example, as of fiscal year 2014 there were 222 I.R.C. § 501(d) religious and apostolic associations, 29,462 I.R.C. § 527 political organizations, and 125,177 non-exempt trusts also within the division's jurisdiction. IRS DATA BOOK 2014, at 56-58.

¹⁷ U.S. GOV'T ACCOUNTABILITY OFF., GAO-05-561T, TAX-EXEMPT SECTOR: GOVERNANCE, TRANSPARENCY, AND OVERSIGHT ARE CRITICAL TO MAINTAINING PUBLIC TRUST 7 (2005) [hereinafter GAO 2005 REPORT].

period, although revenues and to a lesser extent assets have varied more.¹⁸ In 2012, the latest year reported by the IRS, private foundations had assets worth approximately \$633 billion and total annual revenue of approximately \$95 billion.¹⁹

The growth in the number and financial resources of exempt organizations follows a trend that dates back to at least 1975 and likely earlier.²⁰ The decline in the number of organizations (but not the reported financial resources) after fiscal year 2010 is primarily the result of Congress automatically revoking the exempt status of organizations that failed to file three consecutive required annual information returns after 2006.²¹ While some of those organizations were active, most of them likely had ceased operations and so did not represent a significant amount of activities, assets, or revenues.²²

As for IRS resources dedicated to overseeing exempt organizations, the IRS does not release separate budget figures for its Exempt Organizations Division.²³ In recent years, however, the Government Accountability Office (GAO) has provided information about the number of employees within this division.

¹⁸ See Cynthia Belmonte, *Domestic Private Foundations and Related Excise Taxes, Tax Year 2009*, STAT. INC. BULL. 114, 115 (Winter 2013); Melissa Ludlum, *Domestic Private Foundations, Tax Years 1993-2002*, STAT. INC. BULL. 162, 163 (Fall 2005).

¹⁹ IRS, SOI TAX STATS – DOMESTIC PRIVATE FOUNDATION AND CHARITABLE TRUST STATISTICS, <http://www.irs.gov/uac/SOI-Tax-Stats-Domestic-Private-Foundation-and-Charitable-Trust-Statistics> [<http://perma.cc/MC8F-YQDG>] (see Statistical Tables, Domestic Private Foundations: Number and Selected Financial Data, Tax Year 2012, cells X11 & D11).

²⁰ See Alicia Meckstroth & Paul Arnsberger, *A 20-Year Review of the Nonprofit Sector, 1975-1995*, STAT. INC. BULL. 149, 151, 153 (Fall 1998).

²¹ U.S. GOV'T ACCOUNTABILITY OFF., GAO-15-164, TAX-EXEMPT ORGANIZATIONS: BETTER COMPLIANCE INDICATORS AND DATA, AND MORE COLLABORATION WITH STATE REGULATORS WOULD STRENGTHEN OVERSIGHT OF CHARITABLE ORGANIZATIONS 11 (2014) [hereinafter GAO 2014 EO REP.].

²² See Amy S. Blackwood & Katie L. Roeger, *Revoked: A Snapshot of Organizations That Lost Their Tax-Exempt Status*, URBAN INSTITUTE, at 2 (Aug. 2011), <http://www.urban.org/sites/default/files/alfresco/publication-pdfs/412386-Revoked-A-Snapshot-of-Organizations-that-Lost-their-Tax-Exempt-Status.pdf> [<http://perma.cc/C5S4-KC72>]; Linda M. Lampkin, *Automatic Revocation of Nonprofits' Tax-Exempt Status: What Nonprofits, Grantmakers, and Donors Need to Know* 3 (July 27, 2010), <https://www.guidestar.org/ViewCmsFile.aspx?ContentID=2947> [<https://perma.cc/Q9N6-8JYX>].

²³ The Staff of the Joint Committee on Taxation has on occasion obtained these figures, however. See, e.g., STAFF OF THE JOINT COMM. ON TAXATION, JCS-3-00, REPORT OF INVESTIGATION OF ALLEGATIONS RELATING TO INTERNAL REVENUE SERVICE HANDLING OF TAX-EXEMPT ORGANIZATION MATTERS 120 (2000) [hereinafter JCT 2000 REPORT].

Table 3: IRS Exempt Organizations Division Employees²⁴ (full-time equivalents)

Fiscal Year	Total	Examinations	Determinations/Rulings & Agreements ²⁵	Education Outreach & Other
2000	798	424	342	32
2005	856	467	347	42
2010	889	529	341	19
2011	886	534	328	24
2012	858	516	319	23
2013	842	493	326	23

Looking further into the past, for fiscal year 1975 the IRS reported devoting an average of 495 field professional positions to the examination of exempt organization returns.²⁶ While this earlier figure is not directly comparable to the figures from recent years, it suggests that the number of employees dedicated to examinations in fiscal year 2013 is about the same as almost 40 years earlier.²⁷ For fiscal year 1975 the IRS reported 658 average positions, with 666 employees at the end of the year, indicating that the Exempt Organization Division in fiscal year 2013 had about 20 percent more employees total than 38 years earlier.²⁸ The reliability of this figure is unclear, however, as a 1977 report stated that “[a]bout 1,000 IRS employees administer the exempt organization provisions of the Internal Revenue Code,” or about 160 more employees than do so today.²⁹ Regardless of the exact figures, however, during approximately the same time period the number of organizations exempt under I.R.C. § 501(c) has almost doubled and the financial resources controlled by the most common organizations has increased by 50 percent or more over just the fourteen years from 1995 to 2011 (adjusting for inflation).³⁰ And both the applicable law and the main forms filed by exempt organizations have increased in complexity and length, as detailed later in this Part.³¹

The IRS employees dedicated to exempt organization matters do not operate in a vacuum. Rather, they enjoy significant support from other parts of the IRS and the federal government. These other parts include: service center, technology, other support, and appeals staff within the IRS; Chief Counsel staff and other Treasury employees who help

²⁴ GAO 2014 EO REP., *supra* note 21, at 20; GAO 2005 REPORT, *supra* note 17, at 41; *see also* JCT 2000 REPORT, *supra* note 23, at 60 (862 and 946 total EO staff in fiscal years 1990 and 1995, respectively).

²⁵ The figures for 2000 and 2005 are for “Determinations” while the figures for later years are for “Rulings & Agreements,” a broader function that included determinations.

²⁶ COMM’R OF INTERNAL REVENUE, ANN. REP. 1975, at 41.

²⁷ *See also* U.S. GENERAL ACCOUNTING OFF., GAO-02-526, TAX-EXEMPT ORGANIZATIONS: IMPROVEMENTS POSSIBLE IN PUBLIC, IRS, AND STATE OVERSIGHT OF CHARITIES 23 (2002) [hereinafter GAO 2002 REPORT] (IRS Tax Exempt and Government Entities staffing remained essentially flat from 1974 to 1997).

²⁸ *See* COMM’R OF INTERNAL REVENUE, *supra* note 26, at 147.

²⁹ David Ginsburg et al., *Federal Oversight of Private Philanthropy*, in 5 COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS, RESEARCH PAPERS 2578, 2581 (1977).

³⁰ *See* Bureau of Labor Statistics, CPI Inflation Calculator, http://www.bls.gov/data/inflation_calculator.htm [<http://perma.cc/R9WB-ASNC>] (used to adjust 1995 figures to 2011 dollars); *supra* notes 10, 12 and accompanying text.

³¹ *See infra* notes 48-50, 60-62 and accompanying text.

with exempt organizations matters; and attorneys within the Department of Justice's Tax Division who litigate certain disputes with exempt organizations.³² Information regarding how the availability of these other supports has varied over time is not readily available, however.

B. Applications for Recognition of Exemption

For fiscal year 1970, the IRS reported receiving 23,349 applications and issuing 17,367 determination letters, representing a steady increase in both applications and determination letters from the comparable figures four years earlier (17,361 and 14,394, respectively).³³ For fiscal year 1980 the IRS reported having processed 49,534 applications, with 36,980 approved, 1,914 denied, and 10,640 withdrawn or otherwise disposed of without a determination.³⁴ The following table shows more detailed information that the IRS has made available in recent years regarding the applications that it closed.

Table 4: Applications Closed³⁵

Fiscal Year	Charitable (501(c)(3))				Other 501(c)			
	Total	Approved	Denied	Other	Total	Approved	Denied	Other
1995	56,408	42,324	377	13,707	10,866	8,289	242	2,355
2000	74,534	61,005	456	13,073	8,120	6,229	26	1,865
2005	77,539	63,402	765	13,372	6,029	4,801	16	1,212
2010	59,945	48,934	500	10,511	5,600	4,726	13	628
2011	55,319	49,677	205	5,437	5,656	5,016	10	609
2012	51,748	45,029	123	6,596	9,027	7,547	20	1,127
2013	45,289	37,946	79	7,264	7,750	6,162	9	1,116
2014	100,032	94,365	67	5,600	17,493	16,289	22	1,182

Other resolutions include applications withdrawn by the organization, applications that did not provide required information or were otherwise incomplete, or applications on

³² See IRS, TODAY'S IRS ORGANIZATION, <http://www.irs.gov/uac/Today's-IRS-Organization> [<http://perma.cc/4VMW-PG5M>]; U.S. DEPARTMENT OF THE TREASURY, TAX POLICY, <http://www.treasury.gov/about/organizational-structure/offices/Pages/Tax-Policy.aspx> [<http://perma.cc/7KD4-3VNM>]; U.S. DEPARTMENT OF JUSTICE, TAX DIVISION, <http://www.justice.gov/tax> [<http://perma.cc/X699-HN6V>].

³³ COMM'R OF INTERNAL REVENUE, 1970 ANN. REP. 26.

³⁴ IRS 1980 ANNUAL REPORT 76.

³⁵ See IRS DATA BOOK 1995, at 25; IRS DATA BOOK 2000, at 23; IRS DATA BOOK 2005, at 39; IRS DATA BOOK 2010, at 55; IRS DATA BOOK 2011, at 55; IRS DATA BOOK 2012, at 55; IRS DATA BOOK 2013, at 55; IRS DATA BOOK 2014, at 57.

which the IRS refused to rule.³⁶ Data from the 1990s indicates that during the decade more than two-thirds of other resolutions were for failure to establish exemption.³⁷

The IRS does not generally release the number of applications it receives each fiscal year. In 2012 congressional testimony, however, a senior IRS official reported that the IRS receives approximately 60,000 applications annually, of which more than 50,000 are for exemption under I.R.C. § 501(c)(3).³⁸ This latter figure is similar to an Urban Institute estimate of I.R.C. § 501(c)(3) applications for the period from 2001 through 2011 of between approximately 45,000 to slightly over 50,000 per year.³⁹ The reason why the number of closed I.R.C. § 501(c)(3) applications is so much higher than that figure in 2000 and 2005 is apparently because before 2009 the IRS included in the closed applications figure private foundation status rulings that many applicants routinely received five years after their initial application; these closed “foundation follow-up cases” averaged over 19,000 annually from 2001 to 2008.⁴⁰ Closed cases also reflect some other types of determinations, but based on the apparent number of applications those other determinations are probably relatively rare.⁴¹

In recent years, however, the IRS has seen a sharp increase in applications due to organizations seeking reinstatement after automatic revocations began in 2011.⁴² When the Department of the Treasury submitted the new Form 1023-EZ and revised Form 1023 to the Office of Management and Budget for review in 2014, it stated that annually there are approximately 80,000 applications for recognition under I.R.C. § 501(c)(3) alone, which presumably included requests for reinstatement.⁴³

Therefore, the decline in the number of applications processed from 2010 to 2013 reflects not a reduction in the number of applications submitted but rather an increased backlog of pending applications, including requests for reinstatement.⁴⁴ This backlog reached more than 60,000, which at the then current processing pace would have taken the IRS more than a year to clear.⁴⁵ Using the streamlined procedures and application form

³⁶ See, e.g., IRS DATA BOOK 2014, at 57 n.2.

³⁷ See STAFF OF THE JOINT COMM. ON TAXATION, DESCRIPTION OF PRESENT LAW RELATING TO CHARITABLE AND OTHER EXEMPT ORGANIZATIONS AND STATISTICAL INFORMATION REGARDING GROWTH AND OVERSIGHT OF THE TAX-EXEMPT SECTOR 41 (2004).

³⁸ *Public Charity Organizational Issues, Unrelated Business Income Tax, and the Revised Form 990: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 112th Cong. 5, 8 (2012) [hereinafter *2012 Hearings*] (statement of Steven T. Miller, Deputy Commissioner of Services and Enforcement, Internal Revenue Service).

³⁹ Amy S. Blackwood & Katie L. Roeger, *Applications for 501(c)(3) Tax-Exempt Status Declining: Recession or Rule Change?*, URBAN INSTITUTE, at 2 (2013), <http://www.urban.org/research/publication/applications-501c3-tax-exempt-status-declining-recession-or-rule-change> [<http://perma.cc/2PTH-LDQJ>].

⁴⁰ *Id.* at 1-2.

⁴¹ See, e.g., IRS DATA BOOK 2014, at 57 n.1.

⁴² See Eric B. Carriker et al., *Exempt Organizations: Leveraging Limited IRS Resources in the Tax Administration of Small Tax-Exempt Organizations*, in ADVISORY COMMITTEE ON TAX EXEMPT AND GOV'T ENTITIES, 2013 REPORT OF RECOMMENDATIONS 10; 1 NAT'L TAXPAYER ADVOC., 2012 ANN. REP. TO CONGRESS 194, 196.

⁴³ See Submission for OMB Review: Comment Request, 79 Fed. Reg. 18124, 18125 (Mar. 31, 2014).

⁴⁴ See NAT'L TAXPAYER ADVOC., SPECIAL REPORT TO CONGRESS: POLITICAL ACTIVITY AND THE RIGHTS OF APPLICANTS FOR TAX-EXEMPT STATUS 27 (2013); *supra* note 42.

⁴⁵ See Press Release, IRS, New 1023-EZ Form Makes Applying for 501(c)(3) Tax-Exempt Status Easier; Most Charities Qualify (July 1, 2014), <http://www.irs.gov/uac/Newsroom/New-1023-EZ-Form-Makes-Applying-for-501c3Tax-Exempt-Status-Easier-Most-Charities-Qualify> [<http://perma.cc/RB29-Q8GV>].

described in Part III.C.1 below, in fiscal year 2014 the IRS more than doubled the number of applications closed.⁴⁶ At the same time, however, the proportion of applications denied or resolved by means other than approval or denial dropped significantly (from 0.17% to 0.08% and from 15.8% to 5.8%, respectively).⁴⁷

Over time, the application forms have become lengthier and more complex. For example, the Form 1023 for organizations seeking recognition of exemption under I.R.C. § 501(c)(3) has grown from four pages when it was first introduced in the early 1950s to twelve pages, plus fourteen pages of schedules that apply to certain types of organizations.⁴⁸ The counterpart form for organizations seeking recognition of exemption under other provisions of I.R.C. § 501(c) has grown from two pages in the early 1960s to six pages, plus thirteen pages of schedules that apply to certain types of organizations.⁴⁹ At least part of this growth is attributable to the increasing complexity of the statutes and other federal tax rules governing exemption.⁵⁰

C. Annual Information Returns and Examinations

As noted above, Congress did not generally require exempt organizations to file annual information returns until 1944.⁵¹ Even then, there were apparently no examinations of such returns before 1954 unless the IRS received a complaint.⁵² The IRS examined the returns of 13,000 exempt organizations in 1966 but only the returns of 8,500 organizations in 1970.⁵³ This decline was part of the impetus for IRS to create the Exempt Organization Examination Branch in 1970 and to implement other structural changes to increase its capacity for overseeing exempt organizations. Examinations appear to have peaked in fiscal year 1973, when the IRS examined the returns of almost 19,000 organizations; close to 15,000 of these organizations were private foundations, as required to fulfill a commitment by the then IRS Commissioner to examine all private foundations within five years of the new rules imposed on them by Congress in 1969.⁵⁴ The following table shows the examination information reported by the IRS for more recent years.

⁴⁶ See *supra* note 35 and accompanying text.

⁴⁷ See *id.*

⁴⁸ Karen A. Gries et al., *Exempt Organizations: Form 1023 – Updating It for the Future*, in ADVISORY COMMITTEE ON TAX EXEMPT AND GOV'T ENTITIES, REPORT OF RECOMMENDATIONS 6 (2012); see also IRS Form 1023 (revised Dec. 2013).

⁴⁹ See IRS Form 1024 (revised Sept. 1998); IRS Form 1024 (revised June 1962), <http://texashistory.unt.edu/ark:/67531/metaph250819/m1/1/> [<http://perma.cc/E8TH-MGAR>].

⁵⁰ See Nicole S. Dandridge, *Choking Out Local Community Service Organizations: Rising Federal Tax Regulation and Its Impact on Small Nonprofit Entities*, 99 KY. L.J. 695, 708 (2011).

⁵¹ *Supra* note 8 and accompanying text.

⁵² Ginsburg et al., *supra* note 29, at 2584.

⁵³ *Id.* at 2584-85; see also COMM'R OF INTERNAL REVENUE 1970 ANN. REP. 24-26.

⁵⁴ *Id.* at 2610.

Table 5: Exempt Organization Returns Examined⁵⁵

Fiscal Year	All Annual Returns Filed	Form 990/990-EZs Examined	Other Annual Returns Examined	Percent Annual Returns Examined	Other Returns Examined
1995	523,191	3,852	380	0.8%	6,265
2000	719,928	3,630	200	0.5%	3,605
2005	849,342	2,402	362	0.3%	2,189
2010	776,300	3,596	329	0.5%	7,524
2011	858,865	2,962	240	0.4%	8,849
2012	798,903	2,918	125	0.4%	7,700
2013	771,675	2,774	138	0.4%	7,693
2014	765,395	2,579	246	0.4%	5,259

Annual returns include Form 990, Form 990-EZ, Form 990-PF (for private foundations), Form 1041-A (relating to certain trusts), Form 1120-POL (relating to certain political organizations), and Form 5227 (also relating to certain trusts).⁵⁶ In contrast, other returns are returns that exempt organizations normally file in addition to its annual information return, such as Form 990-T (unrelated business income tax).⁵⁷

The number of annual returns examined does not necessarily equal the number of organizations that had their annual returns examined, as the IRS might choose to examine returns from multiple years for a single organization.⁵⁸ Also, while the percentage provided is based on the number of annual returns examined in a given fiscal year compared to the number of annual returns filed during the calendar year ending in that fiscal year, it only provides a rough estimate of examination coverage because the returns examined in a given fiscal year were usually filed in earlier years.⁵⁹

As with the application form, the annual information returns have also generally grown longer and more complex over time, where the number of pages acts as a rough measure of their length and complexity. Occurring in 2007, the most recent major revision of the Form 990 resulted in a form with eleven pages that all filers must complete and sixteen schedules that certain organizations may also need to complete (and since then the

⁵⁵ See IRS DATA BOOK 1995, at 14, 33; IRS DATA BOOK 2000, at 20; IRS DATA BOOK 2005, at 32-33; IRS DATA BOOK 2010, at 33; IRS DATA BOOK 2011, at 33; IRS DATA BOOK 2012, at 33; IRS DATA BOOK 2013, at 33; IRS DATA BOOK 2014, at 34.

⁵⁶ See, e.g., IRS DATA BOOK 2014, at 34 n.1.

⁵⁷ See, e.g., *id.* at 34.

⁵⁸ See GAO 2002 REPORT, *supra* note 27, at 22; Marcus S. Owens, *Charity Oversight: An Alternative Approach* 2 n.2 (2013), http://academiccommons.columbia.edu/download/fedora_content/download/ac:168629/CONTENT/Owens_-_Charity_Oversight_An_Alternative_Approach.pdf [<http://perma.cc/6R9M-ZE2X>].

⁵⁹ Owens, *supra* note 58, at 2 n.2.

main form has grown to twelve pages).⁶⁰ By comparison, the form was only a single page long in 1968, and before the 2007 revision, it was only nine pages long with two possible schedules (including a seven-page schedule applicable to most I.R.C. § 501(c)(3) organizations).⁶¹ A significant part of the most recent growth in the length of the form appears to have been driven by the IRS's addition of numerous inquiries relating to governance issues.⁶²

There are several important additional caveats to this return and examination information. First, churches (of all faiths) and certain church-related entities are exempt from the annual return requirements.⁶³ While the IRS can still examine a church, the existence of special statutory protections for churches and, in recent years, questions about the proper implementation of those protections have made examinations of churches very rare.⁶⁴ Second, there are financial filing thresholds for the Form 990 and, after it was introduced in 1989, the Form 990-EZ.⁶⁵ The threshold for most exempt organizations having to file the Form 990-EZ is having annual gross receipts of more than \$50,000.⁶⁶ While the financial filing thresholds have varied over time, their existence means that many smaller exempt organizations had not been required to file annual information returns before Congress imposed that requirement on all exempt organizations (except churches and certain church-related entities) in 2006.⁶⁷ For these smaller organizations, the IRS now requires the online Form 990-N, which only asks for eight items of information.⁶⁸ In fiscal year 2014, the IRS received 470,895 of these Forms 990-N.⁶⁹ The IRS does not appear to release any information regarding the number of examinations involving the Form 990-N, but it has procedures in place for such examinations and has recently stated that it instituted

⁶⁰ See IRS, Overview of Form 990 Redesign for Tax Year 2008 (2007), http://www.irs.gov/pub/irs-tege/overview__form_990_redesign.pdf [<http://perma.cc/9HKV-UBMA>]; IRS, Form 990 (2014), <https://www.irs.gov/pub/irs-pdf/f990.pdf> [<https://perma.cc/GHD2-HJLM>].

⁶¹ See IRS Form 990 (1968), <http://www.irs.gov/pub/irs-prior/f990shf--1968.pdf> [<http://perma.cc/KU5W-8FAL>] (for exempt organizations other than those exempt under I.R.C. § 501(c)(3)); IRS, Form 990-A (1968), <http://www.irs.gov/pub/irs-prior/f990asf--1968.pdf> [<http://perma.cc/CST5-5U9R>] (for organizations exempt under I.R.C. § 501(c)(3)); IRS, Form 990 (2007), <http://www.irs.gov/pub/irs-prior/f990--2007.pdf> [<http://perma.cc/22W5-ESHL>]; IRS, 2007, Instructions for Form 990 and Form 990-EZ, at 5 (2007), <http://www.irs.gov/pub/irs-prior/i990-ez--2007.pdf> [<http://perma.cc/2EEF-9GGA>]; IRS, Schedule A, Form 990 (2007), <http://www.irs.gov/pub/irs-prior/f990sa--2007.pdf> [<http://perma.cc/V48K-H2XX>].

⁶² See Rummana Alam, Note, *Not What the Doctors Ordered: Nonprofit Hospitals and the New Corporate Governance Requirements of the Form 990*, 2011 U. ILL. L. REV. 229, 240.

⁶³ *Supra* note 17 and accompanying text.

⁶⁴ See I.R.C. § 7611 (2014); Prop. Treas. Reg. § 301.7611-1, 74 Fed. Reg. 39003 (Aug 5, 2009); U.S. GOV'T ACCOUNTABILITY OFF., GAO-15-514, IRS EXAMINATION SELECTION: INTERNAL CONTROLS FOR EXEMPT ORGANIZATION SELECTION SHOULD BE STRENGTHENED 25-26 (2015) [hereinafter GAO 2015 REP.].

⁶⁵ See *Service Considering Improvements to Collection of UBIT Information*, 42 TAX NOTES 1053 (1989).

⁶⁶ IRS, 2014 Instructions for Form 990-EZ, at 4 (2014), <https://www.irs.gov/pub/irs-pdf/i990ez.pdf> [<https://perma.cc/EX7H-VG3W>].

⁶⁷ See Pension Protection Act of 2006, Pub. L. No. 109-280 § 1223, 120 Stat. 780, 1090 (2006) (codified at I.R.C. § 6033(i)); IRS, ANNUAL ELECTRONIC FILING REQUIREMENT FOR SMALL EXEMPT ORGANIZATIONS – FORM 990-N (E-POSTCARD), <http://www.irs.gov/Charities-&-Non-Profits/Annual-Electronic-Filing-Requirement-for-Small-Exempt-Organizations-Form-990-N-%28e-Postcard%29> [<http://perma.cc/BW6D-VTVK>] [hereinafter IRS FORM 990-N WEBSITE] (last updated April 21, 2015).

⁶⁸ IRS FORM 990-N WEBSITE, *supra* note 67.

⁶⁹ IRS DATA BOOK, 2014, at 34 n.1.

compliance checks on hundreds of organizations that had filed the form since they appeared to be ineligible to do so.⁷⁰

D. Guidance, Rulings, Technical Advice and Other Activities

The IRS also provides precedential guidance in a variety of forms, responds to taxpayers' formal requests for rulings, issues technical advice in response to requests made either by IRS employees or by organizations during the course of examinations, and responds to other correspondence both from the public and from members of Congress.

Table 6: Other Activities⁷¹

Fiscal Year	Guidance	Technical Advice and Assistance	Closed Ruling Requests from Taxpayers	Correspondence
2000	10	26	2,182	595
2005	7	22	1,664	501
2010	7	33	400	525
2011	18	27	390	607
2012	15	37	357	702
2013	8	24	566	810
2014	16	33	724	735

Guidance is defined as regulations, revenue rulings, revenue procedures, notices, announcements, and information/news releases.⁷² Annual IRS reports from earlier years show a significantly higher number of regulations, revenue rulings, and revenue procedures issued through the early 1980s, peaking at 84 in fiscal year 1977 (the annual reports did not consistently provide figures for other types of guidance).⁷³ The sharp decline in such guidance, particularly revenue rulings and procedures, coincided with the controversy that erupted over the IRS's handling of private schools with racial discriminatory policies, which culminated in the *Bob Jones University* Supreme Court case.⁷⁴ One critical part of the controversy was a revenue procedure that Congress so disfavored that it passed legislation preventing the IRS from spending any funds to enforce it. This may have led the Treasury and the IRS to shy away from issuing guidance more generally with respect

⁷⁰ See *id.* at 34; IRM 4.75.15.6(2), http://www.irs.gov/irm/part4/irm_04-075-015.html [<http://perma.cc/9MNV-EQ3H>]; IRS EXEMPT ORG., FY 2012 ANN. REP. & FY 2013 WORKPLAN 20 (2012), http://www.irs.gov/pub/irs-tege/FY2012_EO_AnnualRpt_2013_Work_Plan.pdf [<http://perma.cc/ZA7R-ASTK>] [hereinafter EO 2012 ANN. REP.].

⁷¹ See IRS DATA BOOK, 2000, at 22; IRS DATA BOOK, 2005, at 37; IRS DATA BOOK, 2010, at 53; IRS DATA BOOK, 2011, at 53; IRS DATA BOOK, 2012, at 53; IRS DATA BOOK, 2013, at 53; IRS DATA BOOK, 2014, at 55.

⁷² See, e.g., IRS DATA BOOK, 2014, at 55 n.1.

⁷³ See 1975 IRS ANN. REP. 45; 1976 IRS ANN. REP. 45; 1977 IRS ANN. REP. 37; 1978 IRS ANN. REP. 33; 1979 IRS ANN. REP. 25; 1980 IRS ANN. REP. 33; 1981 IRS ANN. REP. 20; 1982 IRS ANN. REP. 17; 1983 IRS ANN. REP. 17; 1984 IRS ANN. REP. 20.

⁷⁴ See *Bob Jones University v. United States*, 461 U.S. 574 (1983).

to exempt organizations.⁷⁵ Beginning at that time, there was also a general decline in revenue rulings, possibly driven by an increasing IRS priority on resolving open cases more swiftly.⁷⁶

Technical advice and assistance refers to written responses to internal requests for legal guidance from IRS employers.⁷⁷ Such technical advice and assistance similarly peaked in the mid-1980s at slightly over 400 annually, and closed ruling requests from taxpayers peaked at close to 6,000 at the same time.⁷⁸ The reason for the sharp decline in later years is not clear, although again there was a general decline in such guidance that began in the 1980s, possibly driven by the increasing IRS priority on resolving open cases more swiftly and without having to issue publicly available (even in redacted form) documents.⁷⁹ The IRS had also begun to take steps that discouraged requests for private letter rulings, including imposing (and then significantly increasing) a fee for such rulings, making more areas off limits for such rulings, and adopting streamlined procedures for some common rulings.⁸⁰ The fact that the amount of both precedential and non-precedential guidance declined generally over the past several decades makes it unlikely that the recent shift in responsibility for guidance relating to exempt organizations from the IRS to the Office of Chief Counsel will cause a resurgence.⁸¹

Finally, the IRS also engages in public education in a variety of ways, including maintaining an extensive website of exempt organization information, drafting and revising publications as needed, hosting various workshops for the public and practitioners, and communicating with the regulated community in numerous ways.⁸² However, the Service has discontinued some forms of public education in recent years, most notably the internal but publicly available articles published as part of the Exempt Organizations Continuing Professional Education Technical Instruction Program.⁸³

E. Current Compliance

Despite these trends, it is not clear to what extent this reduced IRS oversight has led to increased violations of the applicable federal tax laws by exempt organizations. Information regarding such violations, and related violations of applicable state and local

⁷⁵ See Olatunde C. Johnson, *The Story of Bob Jones University v. United States: Race, Religion, and Congress' Extraordinary Acquiescence*, in STATUTORY INTERPRETATION STORIES 126, 137-38 (William Eskridge & Elizabeth Garrett eds., 2010).

⁷⁶ See Marion Marshall et al., *The Changing Landscape of IRS Guidance: A Downward Slope*, 90 TAX NOTES 673, 673 (2001).

⁷⁷ IRM 7.1.2.3.1, 7.1.2.3.2, http://www.irs.gov/irm/part7/irm_07-001-002.html [<http://perma.cc/25V6-YSPL>].

⁷⁸ See 1982 IRS ANN. REP. 59; 1983 IRS ANN. REP. 63; 1984 IRS ANN. REP. 63; IRS, HIGHLIGHTS OF 1985, at 7; 1986 IRS ANN. REP. 59; 1987 IRS ANN. REP. 58; 1988 IRS ANN. REP. 56.

⁷⁹ See Marshall et al., *supra* note 76, at 673-74.

⁸⁰ See *id.* at 674; Rev. Proc. 2015-1, 2015-1 I.R.B. 1, 80 (setting user fees); IRS, Form 8940 Miscellaneous Determination Requests, <https://www.irs.gov/Charities-&-Non-Profits/New-Form-8940-for-Miscellaneous-Determination-Requests> [<https://perma.cc/SVG5-EJJJ>] (last updated Aug. 28, 2015).

⁸¹ IRS Announcement 2014-34, 2014-51 I.R.B. 949; see also Matthew R. Madara, *Realignment of EO Rulings Will Bring New Work Rules*, 146 TAX NOTES 1215 (2015).

⁸² See IRS TAX INFORMATION FOR CHARITIES AND OTHER NON-PROFITS, <http://www.irs.gov/Charities-&-Non-Profits> [<http://perma.cc/M3RF-WN3T>] (last updated Oct. 16, 2015); Carriker, *supra* note 42, at 9-10.

⁸³ See IRS, EXEMPT ORGANIZATIONS-CONTINUING PROFESSIONAL EDUCATION ARTICLES, <http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Continuing-Professional-Education-Technical-Instruction-Program> [<http://perma.cc/VGC3-XN8N>] (last updated May 1, 2015); Kim Barker & Justin Elliott, *How The IRS's Nonprofit Division Got So Dysfunctional*, PROPUBLICA (May 17, 2013).

laws, is almost completely anecdotal.⁸⁴ The IRS estimated a voluntary payment compliance rate for all tax-exempt and government entities in tax year 2001 of 99.87%, the highest rate among the four IRS operating divisions.⁸⁵ It is not clear how reliable or how reflective of actual compliance that figure is, given that violations of the requirements for exemption rarely result in revocation.⁸⁶ At the same time, some instances of noncompliance may not be related to the federal tax law requirements for exemption, such as failures to comply with employment tax rules.⁸⁷

The IRS has attempted to gather more data specifically about compliance with the requirements for exemption within certain subsets of I.R.C. § 501(c)(3) organizations through various projects. Most of those projects have found a relatively limited and minor incidence of noncompliance. For example, the Colleges and Universities Compliance Project resulted in less than 10 percent of colleges and universities surveyed being selected for examination, with examinations uncovering various unrelated business income tax, compensation-setting procedure, and employment tax issues, but no issues that apparently rose to the level that would justify revocation of exempt status.⁸⁸ Similarly, the Hospital Compliance Project did not report any significant compliance issues based on questionnaires received from almost 500 hospitals and led to compensation-focused examinations of only 20 of those hospitals.⁸⁹ While the Political Activities Compliance Initiative led to examinations of over 250 I.R.C. § 501(c)(3) organizations for alleged prohibited political activity, which was substantiated in over half the examinations, the IRS apparently found most violations minor or inadvertent enough that it resolved almost all with only a warning.⁹⁰ The one notable exception is the Credit Counseling Compliance Project, which resulted in revocation of exempt status, completed or proposed, for all 41 completed examinations.⁹¹ But even before this project, credit-counseling organizations only represented a tiny proportion of I.R.C. § 501(c)(3) organizations.⁹²

There are nevertheless some indications that at least minor noncompliance may be relatively widespread in the larger exempt organizations universe. For example, a recent project focusing on large private foundations resulted in additional taxes or penalties in

⁸⁴ See, e.g., Roger Colinvaux, *Charity in the 21st Century: Trending Toward Decay*, 11 FLA. TAX REV. 1, 19-20 (2011); Marion Fremont-Smith & Andras Kosaras, *Wrongdoing by Officers and Directors of Charities: A Survey of Press Reports 1995-2002*, 42 EXEMPT ORG. TAX REV. 25 (2003); Mark Sidel, *The Guardians Guarding Themselves: A Comparative Perspective on Nonprofit Self-Regulation*, 80 CHI.-KENT L. REV. 803, 804-07 (2005).

⁸⁵ IRS, REDUCING THE FEDERAL TAX GAP: A REPORT ON IMPROVING VOLUNTARY COMPLIANCE 16 (2007).

⁸⁶ See Evelyn Brody, *Sunshine and Shadows on Charity Governance: Public Disclosure as a Regulatory Tool*, 12 FLA. TAX REV. 183, 219 & n.139 (2012).

⁸⁷ See Memorandum from J. Russell George to Jacob Lew, *supra* note 4, at 7-8.

⁸⁸ IRS COLLEGES AND UNIVERSITIES COMPLIANCE PROJECT FINAL REP. 2-6 (2013), http://www.irs.gov/pub/irs-tege/CUCP_FinalRpt_042513.pdf [<http://perma.cc/6SK7-Q3WQ>] [hereinafter UNIVERSITIES REP.].

⁸⁹ IRS EXEMPT ORG., HOSPITAL COMPLIANCE PROJECT FINAL REP. 1-5 (2014), <http://www.irs.gov/pub/irs-tege/frethosproj.pdf> [<http://perma.cc/2QZH-6AMS>] [hereinafter HOSPITAL REP.].

⁹⁰ IRS EXEMPT ORG., 2011 WORK PLAN 19-21 (2011), http://www.irs.gov/pub/irs-tege/fy2011_eo_workplan.pdf [<http://perma.cc/4V3A-TQ8B>]. The limited information available on a related sub-project involving political contributions also indicates the IRS resolved almost all confirmed violations with a written warning. See IRS, 2006 POLITICAL ACTIVITIES COMPLIANCE INITIATIVE 6-7 (2007), http://www.irs.gov/pub/irs-tege/2006paci_report_5-30-07.pdf [<http://perma.cc/2R3D-BTAS>].

⁹¹ IRS, CREDIT COUNSELING COMPLIANCE PROJECT 3 (2006), http://www.irs.gov/pub/irs-tege/cc_report.pdf [<http://perma.cc/CZF4-UPZY>].

⁹² *Id.* at 1.

almost half of the closed examinations, although apparently no revocations as of the last report from the IRS.⁹³ And an IRS review of several thousand organizations in the middle of the last decade resulted in 22 percent being referred for examination, including 15 percent of recently established organizations.⁹⁴ Scholars also have identified significant accuracy problems with the annual information returns (the Form 990 series) filed by exempt organizations.⁹⁵ However, many of the inaccuracies appear to stem from arithmetic and other inadvertent errors or from efforts to present the organization in a better light to donors and other potential supporters, rather than representing efforts to hide violations of the federal tax laws.⁹⁶

This limited information has left scholars and other commentators to extrapolate (i.e., guess) the extent to which known violations are reflected in the wider exempt organization sector and, for obvious reasons, these extrapolations vary widely.⁹⁷ It appears, however, that the vast majority of exempt organizations seek to comply with the applicable federal tax laws, with only a small subset of organizations and their leaders being engaged in intentional and significant violations (as apparently frequently occurred in the credit counseling area). But even inadvertent violations are still a concern, especially since exempt organizations, particularly charities, risk a significant loss in public confidence and support from even a relatively low level of noncompliance.⁹⁸ The challenge for the IRS is therefore to help the apparently vast majority of exempt organizations that desire to comply with the applicable tax laws to do so, while at the same time identifying and addressing the relatively small pockets of intentional and significant noncompliance, even as the Service's resources fail to keep pace with the size and complexity of both the exempt organizations community and the applicable law.

III. MODIFYING OVERSIGHT

This Part first briefly reviews the concerns raised by commentators regarding IRS oversight of exempt organizations and related proposals for improving that oversight. It then considers whether there are currently promising candidates for improving oversight in light of the resource constraints the IRS faces, drawing on the extensive literature addressing tax law compliance more generally. This consideration includes describing the

⁹³ EO 2012 ANN. REP., *supra* note 70, at 19.

⁹⁴ TREASURY INSPECTOR GENERAL FOR TAX ADMIN., PERFORMANCE MEASURES AND IMPROVED CASE TRACKING WOULD HELP THE EXEMPT ORGANIZATIONS FUNCTION BETTER ALLOCATE RESOURCES 4 (2008) [hereinafter TIGTA 2008 REP.].

⁹⁵ See Carolyn Cordery, *Light-Handed Charity Regulation: Its Effect on Reporting Practice in New Zealand* 6-7 (Working Paper No. 83, 2011), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2028666 [<http://perma.cc/58EP-MQZ7>] (summarizing this research).

⁹⁶ See GAO 2002 REPORT, *supra* note 27, at 9-13; Elizabeth K. Keating & Peter Frumkin, *Reengineering Nonprofit Financial Accountability: Toward a More Reliable Foundation for Regulation*, 63 PUB. ADMIN. REV. 7 (2003); see also Jeffrey J. Burks, *Accounting Errors in Nonprofit Organizations*, 29 ACCOUNTING HORIZONS 341, 350, 360-61 (2015) (finding a relatively high rate of accounting errors among public charities as compared to U.S. publicly traded companies but no evidence of intentional manipulations, and also finding indications that financial audits of public charities are relatively rigorous and independent).

⁹⁷ See, e.g., Colinvaux, *supra* note 84, at 19-20; Fremont-Smith & Kosaras, *supra* note 84, at 25; Terri Lynn Helge, *Policing the Good Guys: Regulation of the Charitable Sector Through a Federal Charity Oversight Board*, 19 CORNELL J. LAW & PUB. POL'Y 1, 3-5 (2009); Peter Swords, *The Form 990 As An Accountability Tool For 501(c)(3) Nonprofits*, 51 TAX LAW. 571, 573-74 (1998).

⁹⁸ See PANEL ON THE NONPROFIT SECTOR, STRENGTHENING TRANSPARENCY, GOVERNANCE, ACCOUNTABILITY OF CHARITABLE ORGANIZATIONS: A FINAL REPORT TO CONGRESS AND THE NONPROFIT SECTOR 21 (2005) [hereinafter PANEL FINAL REP.]; PAUL C. LIGHT, HOW AMERICANS VIEW CHARITIES: A REPORT ON CHARITABLE CONFIDENCE, 2008, <http://www.brookings.edu/research/papers/2008/04/nonprofits-light> [<http://perma.cc/B2ER-CDVG>]; Swords, *supra* note 97, at 573-74.

recent IRS initiatives to reduce oversight at the application stage and discussing how best to evaluate the effects of such changes.

A. Concerns and Proposals

Concerns about the effectiveness of IRS oversight for exempt organizations are not new, as illustrated by the following passage from a 1977 report prepared under the auspices of the blue-ribbon Commission on Private Philanthropy and Public Needs:

Recently the Service has acknowledged that in the exempt organizations area it fulfills a regulator rather than tax-collecting role. While troubled by the breadth of its responsibility in this area, in which the Service admits that “the tax collector has never been entirely comfortable,” those within the Service who specialize in exempt organizations . . . take this responsibility seriously and attempt to meet it fairly. In doing so, these officials are somewhat handicapped by (a) cumbersome procedures which were designed generally to meet the needs of the tax-collecting branches of the Service; (b) inadequate authority in relation to other officials near the top of the Service’s hierarchy; (c) the understandable emphasis of the Service on its role as tax collector rather than as overseer of a non-revenue-producing activity; and (d) the generally weaker qualifications and training of the Service’s field staff as compared with the National Office staff.⁹⁹

More recently, the Panel on the Nonprofit Sector—organized in response to concerns raised by Congress with respect to IRS oversight of charities—stated that “[f]unding for federal and state oversight of tax-exempt organizations has become increasingly inadequate as the size and complexity of the exempt sector has grown.”¹⁰⁰ The National Taxpayer Advocate’s 2014 Annual Report to Congress noted that Taxpayer Advocate Services cases involving applications for recognition of exempt status have been increasing dramatically in recent years, demonstrating “that the IRS’s processes are creating significant hardship for both new organizations and those whose exempt status was automatically revoked.”¹⁰¹ These concerns were in addition to the more specific concerns regarding the handling of certain applications relating to political activity.¹⁰² Finally, GAO issued a critical report at the end of 2014 highlighting how shrinking resources have made the IRS’s oversight of charitable organizations less extensive and more complicated.¹⁰³ GAO also noted the need for the IRS to develop compliance goals and additional performance measures to assess the impact of its enforcement activities, while at the same time acknowledging the technical difficulty of doing so.¹⁰⁴

Proposals to address these concerns tend to fall into three categories: reorganizing the IRS to enhance the prominence of the exempt organizations function, increasing and improving procedures for gathering and analyzing information relating to exempt organizations, and increasing the financial and personnel resources devoted to the exempt organizations function. For the most part, the IRS and Congress have already implemented

⁹⁹ Ginsburg et al., *supra* note 29, at 2583 (citations omitted).

¹⁰⁰ PANEL FINAL REP., *supra* note 98, at 24.

¹⁰¹ 1 NAT’L TAXPAYER ADVOCATE 2014, ANN. REP. TO CONGRESS 540 [hereinafter 1 NTA 2014 ANN. REP].

¹⁰² NAT’L TAXPAYER ADVOCATE, SPECIAL REP. TO CONGRESS: POLITICAL ACTIVITY AND THE RIGHTS OF APPLICANTS FOR TAX-EXEMPT STATUS (2013); *see also supra* note 1.

¹⁰³ GAO 2014 EO REP., *supra* note 21, at 19-23.

¹⁰⁴ *Id.* at 24-29.

the first category of proposals. In 1969, the IRS doubled the number of revenue agents and tax auditors assigned to exempt organization managers, provided them with special training, and centralized the consideration of such matters in key districts.¹⁰⁵ In 1974, Congress created a new Office of Employee Plans and Exempt Organizations headed by an Assistant Commissioner within the IRS National Office, and the IRS in turn created a separate Exempt Organizations Division within that office as well as Employee Plans and Exempt Organizations offices within its regional and key district field offices.¹⁰⁶ The next 25 or so years saw some slippage with respect to the prominence and particularly the resources allocated to the exempt organizations function within the IRS.¹⁰⁷ Nevertheless, when Congress reorganized the IRS in the late 1990s to shift from a geographic to a functional structure, it retained the prominence of the exempt organizations function within the IRS by making the new Tax Exempt and Government Entities (TE/GE) Division one of the four primary operating divisions, albeit the smallest in terms of budget and personnel.¹⁰⁸ Within that division there is a separate Exempt Organizations (EO) office, headed by an EO Director who reports directly to the TE/GE Commissioner.¹⁰⁹ Given the relatively small size of the exempt organization sector numerically and financially compared to individuals and businesses, any further increase in prominence within the IRS is both unlikely and difficult to justify.¹¹⁰

The second category of proposals is illustrated by the increased obligations imposed on exempt organizations with respect to both the initial application and the annual information return detailed above.¹¹¹ It is also illustrated by IRS efforts to concentrate examinations on certain potential problem areas, such as colleges and universities, credit counseling, hospitals, and political activity, as well as more recent proposals to improve data collection and analysis.¹¹²

The third category of proposals, relating to increased resources, is perhaps the most common although also the least fruitful.¹¹³ As detailed previously, the number of employees and the financial resources dedicated to the IRS's exempt organizations function appears to have been relatively stagnant, even as the number, financial assets, and federal tax law applicable to such organizations has grown significantly.¹¹⁴ At the same time, there appears to be little congressional interest in increasing IRS funding.¹¹⁵

¹⁰⁵ Ginsburg et al., *supra* note 29, at 2585.

¹⁰⁶ *Id.* at 2520, 2622, 2627.

¹⁰⁷ See Robert A. Boisture et al., *How the IRS Plans to Restructure Its Exempt Organization Operations*, 10 J. TAX. OF EXEMPT ORGS. 195, 197-98 (1999); Owens, *supra* note 58, at 3-4.

¹⁰⁸ See Boisture, *supra* note 107, at 201-02.

¹⁰⁹ See IRM 1.1.23.2(1), 1.1.23.5(2), http://www.irs.gov/irm/part1/irm_01-001-023.html [<http://perma.cc/WS55-LQAL>]; IRS, TAX EXEMPT & GOVERNMENT ENTITIES DIVISION AT-A-GLANCE, <http://www.irs.gov/Government-Entities/Tax-Exempt-&-Government-Entities-Division-At-a-Glance> [<http://perma.cc/9G7M-WEHA>]; IRS, TODAY'S IRS ORGANIZATION, <http://www.irs.gov/uac/Today's-IRS-Organization> [<http://perma.cc/J7H7-MZRE>].

¹¹⁰ See, e.g., IRS DATA BOOK, 2014, at 3; IRS, *supra* note 85, at 11.

¹¹¹ See *supra* notes 48-49, 60 and accompanying text.

¹¹² See, e.g., GAO 2014 EO REP., *supra* note 21, at 26; *supra* notes 88-91 and accompanying text.

¹¹³ See, e.g., FREMONT-SMITH, *supra* note 8, at 471; PANEL FINAL REP., *supra* note 98, at 24.

¹¹⁴ See *supra* notes 10, 12, 50, 62 and accompanying text.

¹¹⁵ See, e.g., U.S. GOV'T ACCOUNTABILITY OFF., GAO-15-624, IRS 2016 BUDGET: IRS IS SCALING BACK ACTIVITIES AND USING BUDGET FLEXIBILITIES TO ABSORB FUNDING CUTS 31 (2015); 1 NTA 2014 ANN. REP., *supra* note 101, at 22-23; Jonathan Barry Forman & Roberta F. Mann, *Making the Internal Revenue Service Work*, 17 FLA. TAX. REV. 725 (2015), at 758-65; Memorandum from J. Russell George to Jacob Lew, *supra* note 4, at 1-2.

Realistically, not much more can be done with respect to increasing the prominence of the exempt organizations function within the IRS.¹¹⁶ Nor is a significant increase in resources for the exempt organizations function likely in the foreseeable future, given both the financial state of the federal government and the political unpopularity of the IRS.¹¹⁷ So while securing additional resources for this function will be revisited in Part IV as part of considering possibly moving this function out of the IRS, this Part will assume this function remains within the resource-constrained IRS as currently structured and focuses instead on the possibilities for improving the efficiency of IRS procedures.

There is a rich academic literature discussing how to increase compliance with the tax laws, although it rarely reaches the relative backwater of exempt organizations.¹¹⁸ This literature discusses a variety of process-oriented methods that may be effective with respect to such organizations.¹¹⁹ This Part will first briefly explain why some methods that may be effective with respect to taxpayers generally have little potential with respect to exempt organizations before turning to those methods that have more promise. This Part also focuses on methods that do not require changes in the substantive standards for exempt status. The reason for this limitation is that recent attempts to enact such changes have only resulted in limited legislative enactments addressing specific, identified concerns as opposed to more comprehensive changes that could significantly impact compliance across all or most exempt organizations.¹²⁰ Recent congressional tax reform proposals have also generally not reached the substantive laws governing exemption.¹²¹ In contrast, Congress has recently been willing to enact significant procedural changes relating to reporting and disclosure.¹²²

B. Methods Unlikely to Significantly Improve Oversight

Some of the methods proposed to aid compliance with the federal tax laws are generally a poor fit for exempt organizations. For example, increasing the regulation of or penalties on gatekeepers such as lawyers and accountants is unlikely to be particularly helpful.¹²³ This is both because many exempt organizations do not use such gatekeepers

¹¹⁶ See *supra* notes 105-110 and accompanying text.

¹¹⁷ See CONG. BUDGET OFF., THE BUDGET AND ECONOMIC OUTLOOK: 2015 TO 2025 1 (2015); *supra* note 115 and accompanying text.

¹¹⁸ See, e.g., Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 OHIO ST. L.J. 1453 (2003); Susan Cleary Morse, *Using Salience and Influence to Narrow the Tax Gap*, 40 LOY. U. CHI. L.J. 483 (2009); Alex Raskolnikov, *Revealing Choices: Using Taxpayer Choice to Target Tax Enforcement*, 109 COLUM. L. REV. 689 (2009).

¹¹⁹ See, e.g., U.S. DEP'T OF THE TREASURY, A COMPREHENSIVE STRATEGY FOR REDUCING THE TAX GAP (2006); W. Edward Afield, *Dining with Tax Collectors: Reducing the Tax Gap Through Church-Government Partnerships*, 7 RUTGERS BUS. L.J. 53, 57-58 (2010); Dave Rifkin, *A Primer on the "Tax Gap" and Methodologies for Reducing It*, 27 QUINNIPIAC L. REV. 375, 408-420 (2009).

¹²⁰ See, e.g., Colinvaux, *supra* note 84, at 44-53.

¹²¹ See, e.g., STAFF OF THE JOINT COMM. ON TAXATION, TECHNICAL EXPLANATION OF THE TAX REFORM ACT OF 2014, DISCUSSION DRAFT OF THE CHAIRMAN OF THE HOUSE COMMITTEE ON WAYS AND MEANS TO REFORM THE INTERNAL REVENUE CODE: TITLE V – TAX EXEMPT ENTITIES (JCX-16-14) 38-45 (2014); Press Release, Senate Finance Committee, Hatch, Wyden Launch Bipartisan Finance Committee Tax Reform Working Groups (Jan. 15, 2015) (none of the five working groups focus on exempt organizations) (on file with author).

¹²² See, e.g., Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 9007, 124 Stat. 119, 855-59 (2010); Pension Protection Act, Pub. L. No. 109-280, §§ 1224-1225, 120 Stat. 780, 1091-93 (2006).

¹²³ See generally W. Edward Afield, *A Market for Tax Compliance*, 62 CLEV. ST. L. REV. 315 (2014); Leslie Book, *The Need to Increase Preparer Responsibility, Visibility and Competence*, in 2 NAT'L

and because there is evidence that the exempt organizations most likely to have the resources to engage such gatekeepers, such as colleges, universities, and hospitals, generally have a high level of compliance with the applicable federal tax laws.¹²⁴ Similarly, increasing the penalties for noncompliance imposed on the organizations or their managers would only enhance compliance if the organizations and their leaders are aware of those costs and believe there is a significant risk of discovery of non-compliance.¹²⁵ None of these facts appear to exist with respect to most exempt organizations; most such organizations lack expert advisors to inform them about potential penalties, usually because of resource constraints,¹²⁶ and the current examination rate, and thus the risk of discovery is—and is known to be—very low.¹²⁷

Rewarding whistleblowers and encouraging private enforcement actions through enabling *qui tam* lawsuits are alternative methods for enhancing compliance with the federal tax laws without requiring increased governmental resources, since they enlist private parties to improve compliance.¹²⁸ The success of the existing federal tax whistleblowing program has been relatively limited, however, and has not generated much interest with respect to exempt organizations.¹²⁹ Furthermore, rewards for whistleblowers (and *qui tam* suit filers) are usually a portion of the tax revenue collected as a result, which would not be particularly effective with respect to exempt organizations. Insiders at charities and other exempt organizations may also be less inclined to engage in whistleblowing than employees of for-profit companies because of the potential harm to their organization's mission and those who benefit from its activities. Finally, the exempt organizations area may be particularly vulnerable to damaging harassment if such methods are available, given the controversial nature of some exempt organizations and their usually limited financial resources to defend themselves against false accusations.

Two other methods that have improved compliance significantly, with respect to federal tax laws, are generally also a poor fit for the exempt organizations area. The first

TAXPAYER ADVOCATE, 2008 ANN. REP. TO CONGRESS 74 (2009); Reinier H. Kraakman, *Gatekeepers: The Anatomy of Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53 (1986).

¹²⁴ See Public Charity Organizational Issues, *Unrelated Business Income Tax, and The Revised Form 990: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 112th Cong. 46 (2012) (statement of Eve Borenstein) [hereinafter Borenstein Statement]; *supra* notes 88-90 and accompanying text. The one possible significant exception is private foundations. See Francie Ostrower, *The Role of Advisors to the Wealthy*, in AMERICA'S WEALTHY AND THE FUTURE OF FOUNDATIONS 247, 263-64 (Teresa Odendahl ed., 1987); *supra* note 93 and accompanying text.

¹²⁵ See generally Michael G. Allingham & Agnar Sandmo, *Income Tax Evasion: A Theoretical Analysis*, 1 J. PUB. ECON. 323 (1972); Kyle D. Logue & Gustavo G. Vettori, *Narrowing the Tax Gap Through Presumptive Taxation*, 2 COLUM. J. TAX L. 100, 120 (2011); J. Manhire, *Toward a Perspective-Dependent Theory of Audit Probability for Tax Compliance Models*, 33 VA. TAX REV. 629 (2014); Alex Raskolnikov, *Crime and Punishment in Taxation: Deceit, Deterrence, and the Self-Adjusting Penalty*, 106 COLUM. L. REV. 569 (2006).

¹²⁶ See Borenstein Statement, *supra* note 124, at 46; Gries et al., *supra* note 48, at 3-4.

¹²⁷ See Karen A. Froelich & Terry W. Knoepfle, *Internal Revenue Service 990 Data: Fact or Fiction?*, 25 NONPROFIT & VOLUNTARY SECTOR Q. 40, 49 (1996); *supra* note 55 and accompanying text.

¹²⁸ Dennis J. Ventry, Jr., *Whistleblowers and Qui Tam for Tax*, 61 TAX LAW. 357, 377-79 (2008); Franziska Hertel, Note, *Qui Tam for Tax?: Lessons from the States*, 113 COLUM. L. REV. 1897, 1922-23 (2013). See generally Kneave Riggall, *Should Tax Informants Be Paid? The Law and Economics of a Government Monopsony*, 28 VA. TAX REV. 237 (2008).

¹²⁹ See IRS, WHISTLEBLOWER PROGRAM (INTERNAL REVENUE CODE SECTION 7623) FISCAL YEAR 2014 REP. TO CONGRESS 13-14 (2015), http://www.irs.gov/pub/whistleblower/WB_Annual_Report_FY_14_Final_Signature_June_11-signed%20corrected.pdf [<http://perma.cc/4649-Z8P2>]; Karie Davis-Nozemack & Sarah Webber, *Paying the IRS Whistleblower: A Critical Analysis of Collected Proceeds*, 32 VA. TAX REV. 77, 89 (2012).

is the highly successful introduction of third-party information reporting (e.g., the well-known Form W-2).¹³⁰ In the exempt organizations area, there is no obvious third party to provide information relating to compliance, nor is it clear what information could be reported that would be particularly useful to the IRS.¹³¹ The other such method is the withholding of taxes owed by the source of the taxable income.¹³² However, for exempt organizations, there (usually) is no tax to withhold in the first place.

Beyond these specific process-oriented methods, a significant portion of recent compliance literature discusses methods for shifting the attitudes of taxpayers from the apparently dominant norm of noncompliance with the applicable tax laws, generally through a "responsive regulation" approach.¹³³ This approach includes cooperative compliance efforts that seek to resolve potential IRS-taxpayer disputes in a more cooperative and efficient manner.¹³⁴ Existing, albeit limited, evidence indicates that most exempt organizations and particularly the largest grouping of them (charities) already have a strong pro-compliance bias, however.¹³⁵ There is therefore probably little room to strengthen pro-compliance norms among such organizations generally, and probably not much to be gained from cooperative compliance programs or similar techniques.¹³⁶

Finally, some of the other common methods proposed for improving compliance with the federal tax laws would require the IRS to have significantly more resources, which is not a realistic possibility in the foreseeable future for the reasons already discussed.¹³⁷ For example, more resources would be required to significantly increase guidance and other educational materials given the IRS-wide decline in guidance over the past several decades.¹³⁸ The same obstacle would apply to simply increasing the number of examinations (as opposed to changing examination methods to do more with less, discussed below). Finally, significantly improving the technology used by the IRS would also require substantial additional resources. Indeed, the Treasury Department has identified all three of these areas as priorities for the IRS, but the IRS has made little progress with respect to them precisely because of its shrinking budget.¹³⁹

¹³⁰ See Forman & Mann, *supra* note 115, at 22-23; Leandra Lederman, *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, 60 STANFORD L. REV. 695, 698 (2007).

¹³¹ See Leandra Lederman, *Reducing Information Gaps to Reduce the Tax Gap: When Is Information Reporting Warranted?*, 78 FORDHAM L. REV. 1733, 1739-41 (2010).

¹³² See Lederman, *supra* note 130, at 698. See generally Ajay Mehrotra, "From Contested Concept to Cornerstone of Administrative Practice": *Social Learning and the Early History of U.S. Tax Withholding*, 7 COLUM. J. TAX L. 144 (2016).

¹³³ See generally Valerie Braithwaite, *Responsive Regulation and Taxation: Introduction*, 29 LAW & POL'Y 3 (2007); Marjorie E. Kornhauser, *A Tax Morale Approach to Compliance: Recommendations for the IRS*, 8 FLA. TAX REV. 599 (2007); Lederman, *supra* note 118; Eric A. Posner, *Law and Social Norms: The Case of Tax Compliance*, 86 VA. L. REV. 1781 (2000).

¹³⁴ See, e.g., W. Edward Afield, *Agency Activism as a New Way of Life: Administrative Modification of the Internal Revenue Code Through Limited Issue Focused Examinations*, 7 FLA. TAX REV. 455, 461-72 (2006); Leigh Osofsky, *Some Realism About Responsive Tax Administration*, 66 TAX L. REV. 121, 132-37 (2012); Diane M. Ring, *On the Frontier of Procedural Innovation: Advance Pricing Agreements and the Struggle to Allocate Income for Cross Border Taxation*, 21 MICH. J. INT'L L. 143, 159-69 (2000).

¹³⁵ See *supra* Part II.E.

¹³⁶ But see Betsy Buchalter Adler et al., *Proposal for an Exempt Organizations Voluntary Compliance Program*, in ADVISORY COMMITTEE ON TAX EXEMPT AND GOV'T ENTITIES, REPORT OF RECOMMENDATIONS 61 (2007).

¹³⁷ See *supra* notes 114-115 and accompanying text.

¹³⁸ See Carriker, *supra* note 42, at 2-3, 28-34; *supra* Part II.D.

¹³⁹ See TREASURY INSPECTOR GENERAL FOR TAX ADMIN., ANNUAL ASSESSMENT OF THE INTERNAL REVENUE SERVICE INFORMATION TECHNOLOGY PROGRAM 20 (2014); U.S. DEP'T OF THE TREASURY, *supra*

C. Methods with the Potential to Significantly Improve Oversight

Several methods show more promise, however. The IRS has already implemented one set of such methods by introducing procedures and a new form to streamline the application process for organizations seeking recognition of exempt status as described below. Another set of such methods is greater reliance on resource-intensive examination techniques, such as correspondence audits, no-contact review of operations procedures, and the use of compliance data to better target examinations. A third set of such methods is designed to improve disclosure and transparency to enhance media and public input with respect to exempt organizations, including during both the application and examination processes. A final promising method would be requiring increased electronic filing.

1. Streamlined Application Procedures

The IRS recently made two significant decisions to streamline the application for recognition of exemption process. The first of these decisions was the introduction of an expedited review process for applications submitted by organizations seeking exemption under I.R.C. § 501(c)(4), primarily to clear the backlog of such applications in the wake of the controversy over the handling of them. The second was the introduction of the new Form 1023-EZ, a streamlined application form for certain organizations seeking exemption under I.R.C. § 501(c)(3), along with streamlined procedures for all applications.

a. Expedited Process for Certain I.R.C. § 501(c)(4) Applications

Less than two months after the I.R.C. § 501(c)(4) application controversy exploded in May 2013, newly appointed acting IRS Commissioner Daniel Werfel issued an Initial Assessment and Plan of Action to address the crisis.¹⁴⁰ A major component of the plan was the creation of a voluntary process for expediting I.R.C. § 501(c)(4) applications that had been pending for more than 120 days as of May 28, 2013 and in which the organizations had indicated that they may be involved in political campaign intervention or issue advocacy.¹⁴¹ For eligible applicants that chose to take advantage of this process, the IRS promised to grant their pending application within two weeks if an authorized official of the organization declared, under penalties of perjury, that the organization (1) had spent in each past year and would spend in the current year and each future year 60 percent or more in terms of both expenditures and time (employee and volunteer) on activities promoting social welfare and (2) for each such year had spent or would spend less than 40 percent on participation or intervention in any political campaign on behalf of (or in opposition to) any candidate for public office.¹⁴² The IRS later expanded this program to give itself the option of inviting later filing organizations to make these declarations, and receive a favorable determination in return, if the IRS determined that the

note 119, at 2-3 (three of seven reducing tax gap components are improvements in information technology, improving compliance activities, and enhancing taxpayer service); Memorandum from J. Russell George to Jacob Lew, *supra* note 4, at 6, 13-14.

¹⁴⁰ DANIEL WERFEL, CHARTING A PATH FORWARD AT THE IRS: INITIAL ASSESSMENT AND PLAN OF ACTION (June 24, 2013) <http://www.irs.gov/PUP/newsroom/Initial%20Assessment%20and%20Plan%20of%20Action.pdf> [<http://perma.cc/ZJJ5-WBPL>].

¹⁴¹ *Id.*, App. E.

¹⁴² *Id.*

only potential issues raised by the organization’s application were possible involvement in political campaign intervention or providing private benefit to a political party.¹⁴³

The program has achieved its short-term goal of clearing the backlog of applications raising political campaign intervention issues. The IRS reported that as of August 2015 141 (97 percent) of the 145 organizations that were eligible for the expedited process had had their cases resolved, including 43 organizations that chose the optional expedited process, with the IRS issuing 108 favorable determination letters.¹⁴⁴ Separately, the Treasury Inspector General for Tax Administration (TIGTA) reported that of the 160 applications for recognition of exemption under I.R.C. § 501(c)(4) that involved possible political activity and were open as of December 17, 2012, 149 applications had been closed as of March 2015 and the 11 remaining applications were either in litigation, in Appeals, or had received a proposed adverse determination.¹⁴⁵

b. New Form 1023-EZ & Streamlined Procedures

In mid-2014, the IRS announced a new “Streamlined Application for Recognition of Exemption Under Section 501(c)(3)”—the Form 1023-EZ.¹⁴⁶ Only organizations anticipating relatively low annual gross receipts (\$50,000 or less), owning total assets not exceeding \$250,000, lacking a variety of other characteristics (such as being a church, school, or hospital), and not planning to engage in certain activities (such as credit counseling or maintaining donor advised funds) are eligible to use this new form.¹⁴⁷ For the organizations that are eligible to use the new form, however, relatively minimal information is required and, most importantly, certain key requirements are deemed satisfied as long as an appropriate official of the organization attests that they have been met. These requirements include whether the group’s organizing document contains required provisions (thereby avoiding the need to provide the IRS with an actual copy of that document), whether the group is organized and will be operated exclusively for permitted purposes (thereby avoiding the need to provide a narrative description of the group’s current and planned activities), and whether the group has not and will not conduct prohibited activities such as supporting candidates or providing a substantial private benefit.¹⁴⁸ The application also asks whether the organization will engage in certain permitted but limited or regulated activities, such as attempting to influence legislation, paying compensation to officers, directors, or trustees, and operating overseas.¹⁴⁹

The Form 1023-EZ grew out of streamlined procedures for processing applications for recognition of exemption under any I.R.C. § 501(c) paragraph. The IRS first adopted these procedures for applications that had been pending for more than a year, but then extended these procedures to all pending applications, and finally to new applications as

¹⁴³ IRS, OPTIONAL EXPEDITED PROCESSING EXPANDED TO ALL ELIGIBLE 501(C)(4) APPLICANTS BEGINNING IN DECEMBER 2013, <http://www.irs.gov/Charities-&-Non-Profits/Other-Non-Profits/Expanded-Optional-Expedited-Approval-Process-for-501c4s> [<http://perma.cc/2TX3-KLRN>].

¹⁴⁴ IRS, TIGTA RECOMMENDATION #7: DETAILS AND STATUS, <http://www.irs.gov/Charities-&-Non-Profits/TIGTA-Recommendation-7> [<http://perma.cc/HVG7-MKXL>].

¹⁴⁵ TREASURY INSPECTOR GENERAL FOR TAX ADMIN., STATUS OF ACTIONS TAKEN TO IMPROVE THE PROCESSING OF TAX-EXEMPT APPLICATIONS INVOLVING POLITICAL CAMPAIGN INTERVENTION 16-19 (2015), <http://www.treasury.gov/tigta/auditreports/2015reports/201510025fr.pdf> [<http://perma.cc/F6V6-NYQN>].

¹⁴⁶ See *supra* note 5.

¹⁴⁷ IRS, INSTRUCTIONS FOR FORM 1023-EZ, at 11-17 (revised Aug. 2015), <https://www.irs.gov/pub/irs-pdf/i1023ez.pdf> [<http://perma.cc/BY6Y-6M4G>].

¹⁴⁸ IRS Form 1023-EZ (June 2014).

¹⁴⁹ *Id.*

well.¹⁵⁰ Similar to the Form 1023-EZ, these procedures generally require attestations, as opposed to copies of organizing documents or narrative descriptions to resolve open issues if certain conditions are satisfied.¹⁵¹

As with the optional expedited process for I.R.C. § 501(c)(4) applications, these changes appear to have achieved their short-term goal of clearing the backlog of I.R.C. § 501(c)(3) applications. GAO recently found that the IRS had reduced the inventory of all applications (the vast majority of which were presumably for recognition of I.R.C. § 501(c)(3) status) from 65,718 at the end of fiscal year 2013 to 22,759 at the end of fiscal year 2014, and had closed 117,000 cases in fiscal year 2014 (or more than double the number of cases closed in the previous fiscal year).¹⁵² The IRS also separately reported that the streamlined procedures adopted for all applications had reduced the inventory of cases that were more than 270 days old from 54,564 in April 2014 to 4,791 in September 2014.¹⁵³ The IRS further noted that by December 26, 2014 it had received 20,103 Forms 1023-EZ, representing approximately half of the applications under I.R.C. § 501(c)(3) filed during the period the Form 1023-EZ had been available, and that, on average, the IRS processed Forms 1023-EZ in less than 30 days.¹⁵⁴

c. Criticisms and Evaluation

The limited streamlined application process for certain I.R.C. § 501(c)(4) applicants, as well as the Form 1023-EZ and the broader streamlined process for all I.R.C. § 501(c) applicants, have attracted their share of criticisms. For the former, some commentators viewed it as “giveaway” by the IRS and questioned whether the IRS would have any appetite to later examine the returns of organizations that had taken advantage of this expedited process.¹⁵⁵ Others criticized the IRS for not further clarifying the legal standards regarding what qualifies as political campaign intervention and for requiring at least 60 percent social welfare activity in order to take advantage of the process even though there was no clear legal authority imposing such a requirement.¹⁵⁶

As for the new Form 1023-EZ, even before its introduction the IRS Advisory Committee on Tax Exempt and Government Entities (ACT) recommended against developing it because of the important educational purpose that the Form 1023 served by forcing applying organizations both to consider deeply their activities, finances, and management and to recognize that they would be subject to a comprehensive regulatory regime.¹⁵⁷ ACT was also concerned that such an abbreviated form would not supply

¹⁵⁰ See 1 NAT'L TAXPAYER ADVOCATE, FISCAL YEAR 2015 OBJECTIVES REP. TO CONGRESS 53-54 [hereinafter 1 NTA 2015 OBJECTIVES REPORT].

¹⁵¹ See Memorandum for All Exempt Organizations Rulings and Agreements Employees from Stephen A. Martin, Acting Director, Exempt Organizations, Rulings and Agreements (Mar. 12, 2015), <http://www.irs.gov/pub/foia/ig/spder/IG-TEGE-07-0315-0006%2003-12-2015%5B1%5D.pdf> [<http://perma.cc/R6Z9-GEFG>].

¹⁵² GAO 2014 EO REP., *supra* note 21, at 30; *see supra* note 35 and accompanying text.

¹⁵³ IRS, PROGRESS UPDATE ON FORM 1023-EZ, <http://www.irs.gov/portal/site/irsup/menuitem.143f806b5568dcd501db6ba54251a0a0/?vgnextoid=44beb23f06ffb410VgnVCM1000003b4d0a0aRCRD> [<http://perma.cc/8GZL-V5NS>].

¹⁵⁴ *Id.*

¹⁵⁵ See, e.g., Deirdre Shesgreen, *Critics Question IRS' New "Fast-Track" Path to Tax-Exempt Status*, CINCINNATI ENQUIRER, July 10, 2013, at 3.

¹⁵⁶ See, e.g., *id.*; Press Release, ACLJ, ACLJ Rejects Obama Administration's "Expedited Review" for Conservative Groups Unlawfully Targeted by IRS (July 1, 2013), <http://aclj.org/free-speech-2/aclj-rejects-obama-administration-expedited-review-for-conservative-groups-unlawfully-targeted-by-irs> [<http://perma.cc/K2RX-VFT2>].

¹⁵⁷ Gries et al., *supra* note 48, at 31-32.

information needed by the IRS both to make an accurate determination regarding whether the applying organization qualified for exempt status and to spot potential abuse risks.¹⁵⁸ The National Association of State Charity Officials (NASCO) reiterated these concerns in April 2014, highlighting in particular the increased opportunity for fraud and the resulting heightened burden on federal and state regulators in the long-term.¹⁵⁹ The National Taxpayer Advocate (NTA) also criticized the IRS for introducing the Form 1023-EZ in its current form, and particularly for that form's use of attestations in place of copies of organizing documents and a narrative statement of current and planned activities.¹⁶⁰ While NTA had previously proposed the development of a Form 1023-EZ for use by certain small organizations, the Form 1023-EZ actually introduced by the IRS was developed without consulting the Taxpayer Advocate Service and went much further in reducing the information required than NTA had anticipated.¹⁶¹ Finally, a number of practitioners and other commentators also raised concerns about the Form 1023-EZ not providing sufficient information to the IRS, the applicant, or the public (if the IRS approves the application, which causes it to become public).¹⁶² While the focus of most critics has been on the Form 1023-EZ, some of the same criticisms would also apply to the more general streamlined application procedures to the extent they rely on attestations.

At this point there is no information on whether any of the groups that are seeking I.R.C. § 501(c)(4) exempt status and that took advantage of the new expedited process have acted contrary to their declarations, nor has the IRS announced any specific plans for follow-up examinations of such organizations. There is some preliminary information regarding whether groups benefitting from the broader changes are in fact living up to their attestations, however. According to NTA, when the IRS reviewed a representative sample of Forms 1023-EZ the approval rate for such applications was less than 80 percent, or well below the overall approval rate for such applications of 95 percent through December 26, 2014.¹⁶³ This approval rate is actually less than the overall approval rate prior to the introduction of the Form 1023-EZ and the streamlined procedures, which from 2010 through 2013 ranged from 81.6 percent to 89.8 percent for applications filed under I.R.C. § 501(c)(3).¹⁶⁴ This relatively low approval rate may indicate that the smaller organizations may actually be less likely to make it through the approval process, for whatever reasons (including not responding to IRS inquiries), than larger ones.¹⁶⁵ NTA also reported that a non-representative check of organizational documents for a handful of Form 1023-EZ filers found that most had documents that did not meet the organizational

¹⁵⁸ *Id.*

¹⁵⁹ Letter from Alissa Hecht Gardenswartz, President, NASCO, to Office of Information and Regulatory Affairs (Apr. 30, 2014), <http://www.nasconet.org/wp-content/uploads/2014/05/FINAL-NASCO-comments-re-Form-1023-EZ1.pdf> [<http://perma.cc/X6WR-PBZP>].

¹⁶⁰ 1 NTA 2015 OBJECTIVES REPORT, *supra* note 150, at 55.

¹⁶¹ See 1 NAT'L TAXPAYER ADVOCATE FISCAL YEAR, 2016 OBJECTIVES REP. TO CONGRESS 70 [hereinafter 1 NTA 2016 OBJECTIVES REPORT]; 1 NAT'L TAXPAYER ADVOCATE, 2011 ANN. REP. TO CONGRESS 448 n.44, 562-64 [hereinafter 1 NTA 2011 ANN. REP.].

¹⁶² See Patricia Cohen, *IRS Shortcut to Tax-Exempt Status Is Under Fire*, N.Y. TIMES, Apr. 8, 2015; Fred Stokeld, *Streamlined Exemption Application Could Pose Compliance Problems*, 143 TAX NOTES 439 (2014); David van den Berg, *New IRS Form May Fuel Nonprofit Political Activity*, 144 TAX NOTES 671 (2014); George K. Yin, *The IRS's Misuse of Scarce EO Compliance Resources*, 146 TAX NOTES 267 (2015). But see Manoj Viswanathan, *Form 1023-EZ and the Streamlined Process for the Federal Income Tax Exemption: Is the IRS Slashing Red Tape or Opening Pandora's Box?*, 163 U. PA. L. REV. ONLINE 89 (2014).

¹⁶³ 1 NTA 2016 OBJECTIVES REPORT, *supra* note 161, at 72-73.

¹⁶⁴ See *supra* note 35 and accompanying text.

¹⁶⁵ See 1 NTA 2016 OBJECTIVES REPORT, *supra* note 161, at 75.

test under I.R.C. § 501(c)(3) even though the applicants had attested they satisfied that test.¹⁶⁶ The IRS plans to select another sample of Form 1023-EZ filers for a post-determination compliance program involving correspondence examinations in early fiscal year 2016.¹⁶⁷

While preliminary (and with respect to the organizational documents, anecdotal), these data are troubling. Two other, related sets of data also raise concerns about the accuracy of self-reported information. As noted previously, there are data indicating that exempt organizations' annual returns often contain inaccurate information, even if usually unintentionally.¹⁶⁸ There are also data indicating that a significant number of donors to I.R.C. § 501(c)(3) organizations who claim deductions for noncash contributions fail to properly substantiate those contributions and so may be claiming undeserved tax benefits.¹⁶⁹ While such donors of course have a strong financial incentive to exaggerate the value of their contributions, exempt organizations also have incentives both to mask any possible noncompliance and to provide favorable but inaccurate financial information.¹⁷⁰

The IRS is facing a crisis in the form of a growing backlog of applications, driven in large part by reinstatement requests arising out of the congressionally mandated automatic revocation process, and lacks additional resources to devote to processing those applications. Furthermore, if the vast majority of applicants are seeking exempt status in good faith and desire to comply with the applicable laws, as is likely the case, then it is overly burdensome to require all applicants to go through an overly lengthy process to identify a relatively small number of bad actors (contrary to the concerns raised by ACT and NASCO). This is particularly true given that the application is ill-suited to ferreting out bad actors because much of the information provided is aspirational (what the organization plans to do, as opposed to what it has done or is doing) and the IRS is generally limited to considering the information provided by the organization itself, making deception relatively easy.¹⁷¹

That said, even organizations that desire to comply with the applicable laws need their leaders to have both an understanding of those laws and incentives to make compliance a sufficiently high priority amongst the many competing demands for time and resources for new organizations. Early indications are that new Form 1023-EZ has a significant failure rate in this regard, which does not bode well for the adoption of streamlined procedures that also rely on attestations. This information suggests several areas where further evaluation is needed and, if that further evaluation confirms these concerns, the IRS should make improvements to both the Form 1023-EZ and the streamlined procedures.

With respect to further evaluation, the IRS needs to complete its planned post-determination evaluation of a statistically valid sample of Form 1023-EZ filers to determine whether in fact their attestations were accurate, including with respect to required organizational document provisions. As important, the IRS, or an oversight group

¹⁶⁶ *Id.* at 75.

¹⁶⁷ IRS, *supra* note 153.

¹⁶⁸ See *supra* notes 95-96 and accompanying text.

¹⁶⁹ See TREASURY INSPECTOR GENERAL FOR TAX ADMIN., MANY TAXPAYERS ARE STILL NOT COMPLYING WITH NONCASH CHARITABLE CONTRIBUTION REPORTING REQUIREMENTS 5-6 (2012).

¹⁷⁰ See *supra* note 96 and accompanying text.

¹⁷¹ See *Found. of Human Understanding v. United States*, 88 Fed. Cl. 203, 213-14 (2009); *Church of the Visible Intelligence That Governs the Universe v. United States*, 4 Cl. Ct. 55, 62 (1983).

such as the Government Accountability Office, NTA, or TIGTA needs also to do a similar evaluation of Form 1023 filers that used attestations to resolve outstanding issues with respect to their applications (which the IRS does not appear to currently be planning). While the IRS should also do an evaluation, with respect to politically active organizations seeking I.R.C. § 501(c)(4) status that successfully used the optional streamlined procedure, it is almost certainly not worth the effort from a tax compliance perspective, given the political sensitivity of asking such groups for additional information, the relatively small number of them, and the relatively small amount of tax at issue with respect to them (especially since they only receive exemption, not the ability to receive tax deductible contributions).

If such evaluations reveal a significant level of noncompliance, as early indications imply they will, then both the Form 1023-EZ and the streamlined procedures need to be modified to sufficiently educate organizational leaders about the applicable laws and to reduce opportunities for noncompliance. Possible methods for improving education include requiring applicants to review critical definitions and requirements before providing related attestations on the electronically filed form (as opposed to simply urging them to review the lengthy instructions for that form), providing FAQs for the form (which have not been released even though the form has now been available for over a year), and requiring applicants to complete the eligibility form electronically (with critical definitions and requirements readily available or required to be reviewed) as opposed to simply attesting that they have done so.¹⁷² While in theory it would be helpful if more applicants consulted experienced advisors during the application process, small organizations eligible to complete the Form 1023-EZ are unlikely to have been able to obtain such assistance even if they were still required to complete the Form 1023.¹⁷³ Absent resources to aid such organizations in obtaining professional help, which the IRS is certainly not in a position to provide, it is necessary to better educate the organizational leaders who are almost certainly going to be primarily, if not exclusively, responsible for completing the forms.

Possible methods for reducing noncompliance opportunities include requiring additional information to verify compliance (such as copies of organizational documents, if noncompliance in that area is found to be a significant issue) and selecting a substantial number of applications for close review within a certain time period after a favorable determination.¹⁷⁴ For reasons already discussed, increasing the penalties on individuals who complete the form is less likely to be helpful.¹⁷⁵ The exact educational and compliance-enhancing methods chosen will ultimately depend, however, on the areas of significant noncompliance identified by the further evaluations.

2. *More Efficient Examination Techniques*

Because low examination rates are an issue for all types of taxpayers, commentators have suggested various techniques for more efficiently conducting examinations. Such suggestions are particularly important for the exempt-organizations function, given the new streamlined application processes that reduce the level of initial oversight. These techniques include a greater reliance on correspondence audits, better

¹⁷² See IRS, *supra* note 147, at 3; *supra* note 5.

¹⁷³ See Gries et al., *supra* note 48, at 3.

¹⁷⁴ See Brad Bedingfield, *Blame It on the ROO: From 1023-EZ and Decline of EO Determinations*, 144 TAX NOTES 184 (2014).

¹⁷⁵ See *supra* notes 123-127 and accompanying text.

targeting of examinations, and the expanded use of operations reviews that do not require direct contact with the organization at issue.

Correspondence audits are conducted by mail and are in theory less burdensome for the IRS (and taxpayers) because they eliminate in-person meetings with, and on-site visits by, IRS employees.¹⁷⁶ They also often are more focused than in-person examinations because they are limited to specific issues identified by IRS review of the taxpayer's relevant return(s).¹⁷⁷ The savings can be significant—the GAO recently estimated that the cost per case for an individual income tax correspondence audit is \$274, compared to \$2,278 for a field examination—in terms of IRS resources.¹⁷⁸ Correspondence audits could potentially provide these benefits in the exempt organizations area as well. In fact, approximately a quarter of the examinations that the Exempt Organizations Division completed in fiscal year 2012 were correspondence audits.¹⁷⁹ This proportion is significantly less than the three-quarters for individual audit.¹⁸⁰

Better targeting of examinations is usually accomplished by first examining a statistically valid sample of similar organizations to determine both overall levels of compliance and likely indicators or areas of significant noncompliance.¹⁸¹ Given the diversity of the exempt organizations area in terms of purposes, types of activities, financial size, and complexity, and therefore the likely variance with respect to levels and types of noncompliance, such targeting has the potential to increase the efficiency of IRS oversight of such organizations. The IRS has in fact attempted to use these techniques in this area through the compliance projects cited previously, as well as other “market segment” efforts.¹⁸² The current Exempt Organizations Director recently announced plans to move instead to an issue-based approach.¹⁸³ The GAO has also reported that the IRS is considering additional areas for special focus with respect to Form 1023-EZ filers, including “legislative or overseas activities, compensation issues, and unrelated business activity.”¹⁸⁴

The Review of Operations (ROO) program involves IRS review of an exempt organization's annual returns and of publicly available information, with limited or no contact with the organization at issue unless the organization is referred for an

¹⁷⁶ See U.S. GOV'T ACCOUNTABILITY OFF., GAO-14-479, *IRS CORRESPONDENCE AUDITS: BETTER MANAGEMENT COULD IMPROVE TAX COMPLIANCE AND REDUCE TAXPAYER BURDEN 1-2* (2014) [hereinafter GAO 2014 AUDIT REP.]. They include “limited scope” or “soft contact” examinations and compliance checks that may focus only a single issue. See Karl Emerson et al., *The “RIPPLE” Project: Reviewing IRS Policies and Procedures to Leverage Enforcement: Recommendations to Enhance Exempt Organization's (EO) Enforcement and Compliance Efforts*, in ADVISORY COMMITTEE ON TAX EXEMPT AND GOV'T ENTITIES, REPORT OF RECOMMENDATIONS V-1, V-14 (2004); GAO 2015 REP., *supra* note 64, at 13-14.

¹⁷⁷ See GAO 2014 AUDIT REP., *supra* note 176, at 7.

¹⁷⁸ U.S. GOV'T ACCOUNTABILITY OFF., GAO-13-151, *TAX GAP: IRS COULD SIGNIFICANTLY INCREASE REVENUES BY BETTER TARGETING ENFORCEMENT RESOURCES 6* (2012).

¹⁷⁹ EO 2012 ANN. REP., *supra* note 70, at 5.

¹⁸⁰ See GAO 2014 AUDIT REP., *supra* note 176, at 42.

¹⁸¹ See generally Carolyn Cordery et al., *Differentiated Regulation: The Case of Charities*, ACC. & FIN. (forthcoming 2015); Leigh Osofsky, *Concentrated Enforcement*, 16 FLA. TAX REV. 325 (2014).

¹⁸² See GAO 2002 REPORT, *supra* note 27, at 23-24; BRUCE R. HOPKINS, *IRS AUDITS OF TAX-EXEMPT ORGANIZATIONS: POLICIES, PRACTICES, AND PROCEDURES 137-39* (2008); *supra* notes 88-91 and accompanying text.

¹⁸³ Diane Freda, *IRS Exempt Chief: Sharper, Faster Tool Available in Data-Driven Exams*, 54 DAILY TAX REP. (BNA) No. 54, at G-9 (Mar. 20, 2015); see also GAO 2015 REP., *supra* note 64, at 10-11; IRS, *TE/GE PRIORITIES FOR FY 2016*, at 7 (2015), http://www.irs.gov/pub/irs-tege/TEGE_Priorities_for_FY2016.pdf [<http://perma.cc/4LMV-XC2M>].

¹⁸⁴ GAO 2014 EO REP., *supra* note 21, at 33.

examination.¹⁸⁵ The IRS initiated this program in response to requests for a process to review all organizations several years after they successfully complete the application process, but as established, it also affects older organizations.¹⁸⁶ Commentators have recently renewed calls for such a review in light of the streamlined application processes discussed above.¹⁸⁷

The primary advantage of correspondence audits and the ROO program is that by limiting or even eliminating IRS interactions with exempt organizations, the employee time and other resources devoted to each case are significantly reduced. Recent studies of correspondence audits, conducted outside the exempt organizations area, indicate that this limitation results in at least two significant disadvantages, however. First, communication with the targeted taxpayer is impaired, including through mail delivery failures,¹⁸⁸ low taxpayer responsiveness,¹⁸⁹ and a lack of taxpayer understanding regarding the process and any identified issues.¹⁹⁰ This leads to significant taxpayer dissatisfaction¹⁹¹ and even, possibly, to violations of taxpayers' rights.¹⁹² Second, such audits, at least in the individual income context, tend to be more superficial and less accurate than the field examinations that they displace.¹⁹³ The latter concern also likely applies to the ROO program, given that it relies on IRS filings and publicly available information to identify possible noncompliance as opposed to documents and information requested from the exempt organization, as is the case for examinations.

Greater selectivity with respect to examination targets would in theory permit the IRS to better detect significant pockets of noncompliance (particularly intentional noncompliance), and focus its limited examination resources on those areas. In practice, however, successfully implementing such selectivity is difficult. For example, NTA recently found that the IRS tends not to use the already available information to inform its examination process.¹⁹⁴ In the exempt organizations area, the compliance projects noted earlier either have not been designed to incorporate a statistically valid sample of organizations of a particular type or engaged in a particular activity, or have ultimately failed to do so at the examination stage (rendering the examination results not representative and so of limited utility).¹⁹⁵

The IRS, therefore, needs to evaluate its existing exempt organization correspondence audit, ROO, and its selective examination programs to determine if the

¹⁸⁵ See TIGTA 2008 REP., *supra* note 94.

¹⁸⁶ See *id.* at 1-2, 4.

¹⁸⁷ E.g., Bedingfield, *supra* note 174; see also Evelyn Brody, *Time for an EO-EZ Status for Small Charities*, 147 TAX NOTES 815 (2015) (recommending provisional approval for Form 1023-EZ filers).

¹⁸⁸ See 2 NAT'L TAXPAYER ADVOCATE, 2011 ANN. REP. TO CONGRESS 82 [hereinafter 2 NTA 2011 ANN. REP.].

¹⁸⁹ *Id.* at 86.

¹⁹⁰ See *id.* at 82-83; Leslie Book, *The IRS's EITC Compliance Regime: Taxpayers Caught in the Net*, 81 OR. L. REV. 351, 397-401 (2002).

¹⁹¹ See Ann Marie Maloney, *Correspondence Audits Need Some Work, Tax Community Tells IRS*, J. ACCT. (Feb. 28, 2012), <http://www.journalofaccountancy.com/news/2012/feb/20125227.html> [<http://perma.cc/V6R3-A5Y6>]; NATIONAL TAXPAYER ADVOCATE, ARE IRS CORRESPONDENCE AUDITS REALLY LESS BURDENSOME FOR TAXPAYERS? (Feb. 6, 2012), <http://www.taxpayeradvocate.irs.gov/news/are-irs-correspondence-audits-really-less-burdensome-for-taxpayers> [<http://perma.cc/Y4UU-WF2Z>].

¹⁹² 2 NTA 2011 ANN. REP., *supra* note 188, at 81.

¹⁹³ See *id.* at 71; TREASURY INSPECTOR GEN. FOR TAX ADMIN., 2013-30-099, ACTIONS ARE NEEDED TO STRENGTHEN THE NATIONAL QUALITY REVIEW SYSTEM FOR CORRESPONDENCE AUDITS 2, 5-7 (2013).

¹⁹⁴ See 1 NTA 2014 ANN. REP., *supra* note 101, at 115-17.

¹⁹⁵ See, e.g., HOSPITAL REP., *supra* note 89, at 2-3; UNIVERSITIES REP., *supra* note 88, at 2.

criticisms have merit and, if so, can be resolved favorably. If the same problems apply in the context of exempt organizations targeted for correspondence examinations, it appears most of the highlighted problems could be resolved by providing more accurate information to the targeted organizations regarding the examination process and timeframe and, most importantly, by providing the organizations with the ability to interact, at least by telephone, with the examining agent.¹⁹⁶ While the latter change would be more costly, it appears that the IRS has given resource conservation too high a priority, resulting in unfair treatment of examination targets and in high levels of taxpayer dissatisfaction.

With respect to accuracy and depth issues, if they exist in the exempt organization correspondence audit and ROO programs, they may represent an unavoidable trade-off for the resource savings those programs represent. That trade-off puts even greater importance on gathering and applying data that can be used to selectively target examinations better, both to focus the issues addressed in those programs and to determine what issues or organizations require relatively resource-intensive field examinations as opposed to these less costly, but less thorough, reviews. Here, the IRS needs to do a better job, even at an increased initial investment cost, at conducting statistically valid sampling of major exempt organization categories and activities, so that its limited resources can be better targeted in the future.

3. *Increased Disclosure*

Commentators have cited increased disclosure of information to the public as having the potential to enhance compliance with the federal tax laws both generally and specifically with respect to exempt organizations.¹⁹⁷ This specific application is in large part because the normal presumption of confidentiality of taxpayer information does not generally apply for exempt organizations.¹⁹⁸ Both the IRS and exempt organizations are required to make publicly available applications for recognition of exemption (after the application is granted) and annual information returns, with only relatively limited redactions permitted (e.g., donor information, trade secrets, etc.).¹⁹⁹ Such disclosure has been enhanced both through the increasing amount of information required on these forms²⁰⁰ and through the efforts of private parties, particularly GuideStar, which makes all recent annual returns of exempt organizations available on the Internet.²⁰¹

Even given this high level of existing disclosure, commentators have identified several areas where greater disclosure could enhance compliance with little additional burden on the IRS. One such area is that of pending applications, which are currently not subject to disclosure until the application is approved.²⁰² Another area is that of examinations, which are not subject to disclosure except that if the examination results in revocation of exempt status, that result is made public when it is finalized or litigated; but

¹⁹⁶ See GAO 2014 AUDIT REP., *supra* note 176, at 35-36.

¹⁹⁷ See, e.g., Emerson et al., *supra* note 176, at V-15; Helge, *supra* note 97, at 75; George K. Yin, *Reforming (and Saving) the IRS by Respecting the Public's Right to Know*, 100 VA. L. REV. 1115, 1118 (2014).

¹⁹⁸ See generally 2 STAFF OF THE JOINT COMM. ON TAX'N, JCS-1-00, STUDY OF PRESENT-LAW TAXPAYER CONFIDENTIALITY AND DISCLOSURE PROVISIONS RELATING TO TAX-EXEMPT ORGANIZATIONS 5-6 (2000) [hereinafter JCT DISCLOSURE REP.]; Brody, *supra* note 86, at 203-07; Lloyd Hitoshi Mayer, *Nonprofits, Politics, and Privacy*, 62 CASE W. RES. L. REV. 801, 808-12 (2012).

¹⁹⁹ See I.R.C. § 6104 (2014); JCT DISCLOSURE REP., *supra* note 198, at 34-38.

²⁰⁰ See *supra* notes 48-49, 60-61 and accompanying text.

²⁰¹ See GUIDESTAR, <http://www.guidestar.org> [<http://perma.cc/D66S-GPBB>].

²⁰² See, e.g., JCT DISCLOSURE REP., *supra* note 198, at 86-87; Yin, *supra* note 197, at 1152-57.

even still, such a result is not widely disseminated.²⁰³ Other suggestions include enhancing information-sharing with state regulators, even if that information is not made available to the public.²⁰⁴

Common advantages cited for increased disclosure with respect to taxpayers generally include shaming them into compliance;²⁰⁵ improving public perceptions of the level of compliance; the risk of noncompliance;²⁰⁶ and, particularly for exempt organizations, vindicating the public’s right to know about entities that enjoy significant tax benefits.²⁰⁷ Increased disclosure also has the potential to provide enhanced oversight at little cost to the IRS by essentially enlisting the media and public in reviewing the disclosed information.²⁰⁸ Even commentators who are supportive of increased disclosure acknowledge various risks, however. These risks include potential privacy harms, the risk of harassment for more controversial exempt organizations and their leaders, the risk of disclosing IRS examination selection criteria, the burden on the IRS of managing and enforcing disclosure rules, the burden on the exempt organizations themselves, and the risk of imposing extra-legal requirements.²⁰⁹

Furthermore, disclosure by itself does not necessarily lead to increased oversight—the media and public may choose not to use the revealed information or even to take the time to review it, and state regulators may have other enforcement priorities.²¹⁰ At the same time, the IRS would have to manage any such disclosure system and deal with requests for exceptions based on claims of potential harassment or other legitimate grounds. So while disclosure may improve the public accountability of the IRS, its actual effect on compliance is less certain and may not be worth even its modest burden on the IRS and exempt organizations.²¹¹ At a minimum, the IRS should take steps to evaluate whether, and to what extent, disclosure could enhance the detection of noncompliance.

4. Increased Electronic Filing

A related and widely shared recommendation is to increase the extent of required electronic filing by exempt organizations (“e-filing”). Indeed, strong support for expanded, mandatory e-filing for exempt organizations is found not only throughout the federal government but also in the exempt sector itself.²¹² Currently, e-filing is required only for

²⁰³ See, e.g., JCT DISCLOSURE REP., *supra* note 198, at 84-86; Helge, *supra* note 97, at 75; Yin, *supra* note 197, at 1158-62.

²⁰⁴ See, e.g., GAO 2002 REPORT, *supra* note 27, at 34; Carriker, *supra* note 42, at 34-38.

²⁰⁵ See Jay A. Soled & Dennis J. Ventry Jr., *A Little Shame Might Just Deter Tax Cheaters*, USA TODAY, Apr. 10, 2008, at A11.

²⁰⁶ See Joshua D. Blank & Daniel Z. Levin, *When is Tax Enforcement Publicized?*, 30 VA. TAX REV. 1, 37 (2010).

²⁰⁷ See JCT DISCLOSURE REP., *supra* note 198, at 80; Mayer, *supra* note 198, at 828-29; Yin, *supra* note 197, at 1149-50.

²⁰⁸ See Yin, *supra* note 197, at 1148-49.

²⁰⁹ See JCT DISCLOSURE REP., *supra* note 198, at 81-82; Brody, *supra* note 86, at 204; Antonia M. Grumbach, *Whither Regulation?*, PATTERSON BELKNAP WEBB & TYLER LLP, at 17-18 (Aug. 2008), https://www.pbwt.com/content/uploads/2015/07/A-Grumbach-Paper_Oct-2007-Conference.pdf [<https://perma.cc/5GVN-82S5>]; Gregory Korte, *IRS Assailed From All Sides for Lack of Transparency*, USA TODAY (Aug. 19, 2013, 10:40 AM), <http://www.usatoday.com/story/news/politics/2013/08/18/irs-transparency-tea-party/2668193/> [<http://perma.cc/LU6X-CU2B>].

²¹⁰ See Dana Brakman Reiser, *There Ought To Be a Law: The Disclosure Focus of Recent Legislative Proposals for Nonprofit Reform*, 80 CHI.-KENT L. REV. 559, 607 (2005).

²¹¹ See Robert A. Britton, Note, *Making Disclosure Regulation Work in the Nonprofit Sector*, 2008 U. ILL. L. REV. 437, 452-54. *But see* Brody, *supra* note 86, at 232.

²¹² See, e.g., GAO 2014 EO REP., *supra* note 21, at 41; U.S. DEP’T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION’S FISCAL YEAR 2015 REVENUE PROPOSALS 231 (2014) [hereinafter

the annual information returns filed by the largest organizations and for the Form 1023-EZ and Form 990-N, which only certain, relatively small exempt organizations may use.²¹³

Increased e-filing would enhance both public and IRS access to filed information.²¹⁴ Increased e-filing may also have at least two other significant benefits. First, e-filing may prevent some common errors on both applications and annual returns, as well as help educate applicants about the applicable legal requirements, thereby aiding organizations that desire to file accurate forms but through inadvertent errors fail to do so.²¹⁵ Second, expanded mandatory e-filing could enhance the ability of the IRS to target examination efforts as discussed above. Currently, the IRS is limited in its use of information from electronically filed returns because it can only incorporate in computer analyses information that it also enters from non-electronically filed returns (in order to not disadvantage organizations that electronically file).²¹⁶ If Congress required all exempt organizations to file their annual returns electronically, the IRS could instead analyze all of the submitted information. A survey by the ACT found that few exempt organizations believe e-filing would be burdensome, so the only significant downside to increased mandatory e-filing would be the need for an initial investment by the IRS.²¹⁷ As with the other methods discussed above, however, the IRS would still need to evaluate the results of electronic filing to determine if in fact it leads to the expected compliance benefits.

* * *

The above discussion demonstrates that there are a number of ways to improve compliance by exempt organizations with the applicable federal tax laws through more efficient oversight by the IRS. In addition, enacting these various methods in tandem could create helpful synergies. For example, e-filing could both make disclosure easier and enhance the ability of the IRS to target examinations. None of these methods is without its disadvantages; however, there may be ways to offset or even eliminate them, such as by prioritizing organizations that take advantage of the streamlined application process for examination several years after IRS recognition of exemption.

At the same time, there is no obvious solution. Even if Congress, the Treasury, and the IRS were willing and able to enact, evaluate, and recalibrate all of these methods, as is necessary, it is far from clear that they would be able to significantly enhance compliance by exempt organizations with the applicable federal tax laws, given the current resource limitations faced by the IRS and the unlikelihood of significant changes to the substantive legal standards for exemption. In a climate of pervasive concern regarding

TREASURY 2015 PROPOSALS]; U.S. SENATE COMM. ON FINANCE, THE BUSINESS INCOME TAX BIPARTISAN TAX WORKING GROUP REP. 55-56 (2015); PANEL FINAL REP., *supra* note 98, at 26; Gries et al., *supra* note 48, at 41; Virginia C. Gross et al., *Exempt Organizations: The Redesigned Form 990: Recommendations for Improving its Effectiveness as a Reporting Tool and Source of Data for the Exempt Organization Community*, in ADVISORY COMMITTEE ON TAX EXEMPT AND GOV'T ENTITIES, 2015 REPORT OF RECOMMENDATIONS 85, 141-43.

²¹³ See TREASURY 2015 PROPOSALS, *supra* note 212, at 231; IRS, INSTRUCTIONS FOR FORM 1023-EZ, at 2, <http://www.irs.gov/pub/irs-pdf/i1023ez.pdf> [<http://perma.cc/8S4Y-HVHC>].

²¹⁴ See GAO 2014 EO REP., *supra* note 21, at 35-36; U.S. DEP'T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2016 REVENUE PROPOSALS 248 (2015); Gries et al., *supra* note 48, at 21-22; Gross et al., *supra* note 212, at 104-05.

²¹⁵ See Gries et al., *supra* note 48, at 20-21; Gross et al., *supra* note 212, at 107.

²¹⁶ See Gross et al., *supra* note 212, at 105.

²¹⁷ See *id.* at 118. The initial investment by the IRS may be difficult to obtain, however, if the apparent failure of the Form 1023 Cyber Assistant program is any indication. See 1 NTA 2011 ANN. REP., *supra* note 161, at 441 & n.23.

possible bias in the IRS oversight of exempt organizations, more radical change is ripe for consideration—moving the oversight function out of the IRS completely.

IV. RETHINKING THE LOCUS OF OVERSIGHT

It is an unavoidable reality that the IRS is hobbled both by the awkwardness of adapting its revenue-collection culture and practices to the regulation of exempt organizations and by congressional hostility toward increasing the agency's funding.²¹⁸ As these cultural and resource concerns are far from new, commentators have proposed numerous alternatives to the IRS for housing the oversight role.²¹⁹ Since at least the 1970s, none of these proposals has attracted much attention, acceptance or implementation. The extremity of current circumstances both justifies and renders more realistic the pursuit of an alternative to the IRS, however.

This Part briefly summarizes the proposals for an alternate, national overseer for exempt organizations. A national body, as opposed to state or local bodies, is key because the oversight role flows from federal tax law. This Part then considers the advantages and disadvantages that would likely arise from moving the exempt organization function out of the IRS into either a new federal agency or a new private, self-regulatory body (albeit one closely overseen by the federal government).

A. Proposals for National Alternatives to the IRS

Commentators have developed essentially three national alternatives to the IRS.²²⁰ One proposal is the creation of a new federal regulatory agency. A second is the creation of a federal advisory group. The third is the creation of a national self-regulatory organization.

1. *New Federal Regulatory Agency*

Even as Congress reorganized the IRS in the 1970s to increase the prominence and resources available for the exempt organizations function, several commentators testified before Congress in support of a bolder move with respect to charitable (I.R.C. § 501(c)(3)) organizations: creating a new national entity.²²¹ As later elaborated by others, the proposed agency would be structured along the same lines as the Securities and Exchange Commission (SEC), with commissioners appointed by the President and confirmed by the Senate for set terms.²²² The agency would take over the application, examination, and guidance functions conducted by the IRS (except in instances where such organizations owed unrelated business income tax); would compile and publish data relating to philanthropic organizations and activities; and would advise both Congress and the executive branch on charitable matters.²²³ Others writing at the same time were not supportive of this proposal, however, preferring to put their faith in the then ongoing changes at the IRS.²²⁴ Joel Fleishman revisited this proposal in 1999 but only as a strategy

²¹⁸ See *supra* notes 99-104 and accompanying text.

²¹⁹ See FREMONT-SMITH, *supra* note 8, 461-66; Lloyd Hitoshi Mayer & Brendan M. Wilson, *Regulating Charities in the Twenty-First Century: An Institutional Choice Analysis*, 85 CHI.-KENT L. REV. 479, 495-504 (2010).

²²⁰ See FREMONT-SMITH, *supra* note 8, at 461-63.

²²¹ See Donald R. Spuehler, *The System for Regulation and Assistance of Charity in England and Wales, with Recommendations on the Establishment of a National Commission on Philanthropy in the United States*, in 5 COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS, RESEARCH PAPERS 3045 (1977).

²²² *Id.* at 3080.

²²³ *Id.* at 3080-81.

²²⁴ See Ginsburg et al., *supra* note 29, at 2642-44.

of last resort if other, self-regulatory strategies had failed; he has since shifted his support to a national self-regulatory organization.²²⁵

2. *New Federal Advisory Group*

In the 1970s, two different commissions proposed a new federal advisory group.²²⁶ Such a group would serve an information gathering and sharing role, and would craft recommended best practices and proposals for legislative and regulatory changes, but would not exercise any regulatory authority itself, leaving that role to the IRS and the states.²²⁷ These proposals also failed to gather sufficient support to advance, either then or since.²²⁸ Several private, national organizations have since arisen that serve in essentially this role, however, albeit without a government imprimatur. The most prominent is Independent Sector, which organized the Panel on the Nonprofit Sector.²²⁹ Other such organizations include the Council on Foundations, the Evangelical Council for Financial Accountability (which organized the Commission on Accountability and Policy for Religious Organizations), and the National Council of Nonprofits.²³⁰

3. *New National Self-Regulatory Organization*

In 1999 Fleishman also put forward the idea of a private self-regulatory organization (“SRO”) that would investigate and report malfeasance by unscrupulous individuals or groups and propose best practices that go beyond legal requirements for well-meaning but perhaps unwise or careless groups and their leaders, either as an alternative or in addition to a joint private/public effort.²³¹ Former IRS Exempt Organizations Division Director Marcus Owens modified and further developed this idea, suggesting the creation of a quasi-public SRO that would work with the IRS in a similar manner to how the Financial Industry Regulatory Authority (FINRA) currently works with the SEC.²³² His proposal would create an entity for which membership for organizations seeking to attain or maintain I.R.C. § 501(c)(3) status (or possibly any category of I.R.C. § 501(c) tax-exempt status) would be mandatory and over which representatives of the regulated community would have influence but not control through a board divided equally

²²⁵ See JOEL L. FLEISHMAN, *THE FOUNDATION: A GREAT AMERICAN SECRET* 257-58 (2007); Joel L. Fleishman, *Public Trust in Not-for-Profit Organizations and the Need for Regulatory Reform*, in *PHILANTHROPY AND THE NONPROFIT SECTOR IN A CHANGING AMERICA* 172, 187-91 (Charles T. Clotfelter & Thomas Ehrlich eds. 1999); see also Nina J. Crimm, *A Case Study of a Private Foundation’s Governance and Self-Interested Fiduciaries Calls for Further Regulation*, 50 *EMORY L.J.* 1093, 1192 & n.494 (2001) (endorsing Fleishman’s 1999 proposal).

²²⁶ See ELEANOR L. BRILLIANT, *PRIVATE CHARITY AND PUBLIC INQUIRY: A HISTORY OF THE FILER AND PETERSON COMMISSIONS* 94, 130-31 (2000); *COMMISSION ON FOUNDATIONS AND PRIVATE PHILANTHROPY, FOUNDATIONS, PRIVATE GIVING, AND PUBLIC POLICY* 181-88 (1970) [hereinafter *PETERSON COMM’N REP.*]; Adam Yarmolinsky & Marion R. Fremont-Smith, *Preserving the Private Voluntary Sector: A Proposal for a Public Advisory Commission on Philanthropy*, in 5 *COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS, RESEARCH PAPERS* 2857, 2857-58 (1977).

²²⁷ *PETERSON COMM’N REP.*, *supra* note 226, at 181-88; Yarmolinsky & Fremont-Smith, *supra* note 226, at 2858.

²²⁸ See BRILLIANT, *supra* note 226, at 95, 142-43.

²²⁹ See FREMONT-SMITH, *supra* note 8, at 462; *PANEL FINAL REP.*, *supra* note 98, at 110-112.

²³⁰ See Grumbach, *supra* note 209, at 15-16; COUNCIL ON FOUNDATIONS, <http://www.cof.org> [<http://perma.cc/WP6D-ECEV>]; Press Release, ECFA to Lead Independent Commission on Major Accountability and Policy Issues for Churches and Other Religious Organizations (Jan. 7, 2011); NATIONAL COUNCIL OF NONPROFITS, <https://www.councilofnonprofits.org> [<http://perma.cc/B3Z8-2JZH>].

²³¹ Fleishman, *supra* note 225, at 186-87; see also STAFF OF THE SENATE FINANCE COMM., *DISCUSSION DRAFT 14-15* (2004), <http://www.finance.senate.gov/imo/media/doc/062204stfdis.pdf> [<http://perma.cc/QX3C-8RN6>] (proposing an IRS-supported, privately administered accreditation system).

²³² Owens, *supra* note 58, at 1.

between sector representatives, governmental representatives, and independent "public directors."²³³ The SRO's focus would be on enforcing and interpreting the federal tax laws, but subject to the ability of the IRS to reject or amend proposed rules.²³⁴ As noted above, Fleishman has now endorsed Owens's proposal.²³⁵

B. Considering the Proposals

Before considering the various proposals, it is necessary to determine what characteristics would be optimal for an oversight body charged with ensuring compliance by exempt organizations with the applicable federal tax rules. As noted previously, the body should be national in scope. Other desirable characteristics can be easily gleaned from both the critics of the IRS in this regard and the proponents of the various alternatives: an exclusive focus on overseeing exempt organizations; a realistic possibility of increased funding; a staff capable of impartial, accurate, and professional application of the pertinent federal tax laws; and systems and procedures that reflect a regulatory as opposed to a revenue-collecting focus.²³⁶

The second option—a federal advisory body—is clearly inferior to the other possibilities for at least two reasons. First, it would be duplicative of various private, advisory bodies that have arisen or grown in prominence since the 1970s.²³⁷ Second, because it is advisory in nature, its positions would not be binding on the regulated community and so it would be significantly limited in its ability to promote compliance.²³⁸

The remaining possibilities raise two sets of advantages and disadvantages. One set relates to moving the oversight function out of the IRS, even if it were to remain within the federal government. The second set relates to moving that function out of the federal government to a private SRO, albeit one still tied to the federal government in various ways.

1. Leaving the IRS

The spin off of a regulatory function from an existing agency into a separate federal agency is unusual but not unprecedented. For example, Congress spun the Federal Communications Commission off from the Interstate Commerce Commission (ICC) because the task of regulating telephone service had simply grown too great to leave as a secondary function of the ICC.²³⁹ In a similar way, it appears the exempt organization function has grown from a relatively small role for the IRS to a much larger one both because of the growth in the number and complexity of such organizations and because of increased oversight expectations on the part of Congress and the public.²⁴⁰

Moving some or most of exempt organization oversight to a new federal agency would increase accountability for that oversight, since it would be the sole function of the new agency as opposed to only one function among many at the IRS.²⁴¹ Such a move

²³³ *Id.* at 18-19.

²³⁴ *Id.* at 20.

²³⁵ FLEISHMAN, *supra* note 225, at 257-58; *see also* Helge, *supra* note 97, at 70 (also endorsing this approach, but with significant modifications).

²³⁶ *See* Helge, *supra* note 97, at 20-33; Owens, *supra* note 58, at 4-7; *supra* notes 1, 99-104 and accompanying text.

²³⁷ *See supra* notes 229-230 and accompanying text.

²³⁸ *See* Owens, *supra* note 58, at 7-8.

²³⁹ *See* Kristin E. Hickman, *Pursuing a Single Mission (or Something Closer to It) for the IRS*, 7 COLUM. J. TAX L. 169 (2016).

²⁴⁰ *See supra* Part II.A.

²⁴¹ *See* FLEISHMAN, *supra* note 225, at 256.

would also permit the development of procedures and rules designed for the regulatory nature of this oversight, as opposed to the revenue-collection procedures and rules of the IRS, which include a presumption of taxpayer confidentiality and procedures that delay examinations until after the filing of an annual return.²⁴² Furthermore, it would allow a reboot of the regulator's relationship with the exempt organizations community, providing an opportunity to put the recent I.R.C. § 501(c)(4) application controversy firmly in the rearview mirror (and free the IRS from the risk of similar controversies in the future).²⁴³ Finally, a stand-alone budget would highlight the relatively paltry amount of resources allocated to the exempt organization function and disassociate that function from the unpopular IRS and could lead to greater congressional appropriations.²⁴⁴

Funding can, however, be a double-edged sword. If the funding is done with appropriations of general treasury funds, that may both invite political interference by Congress and lead to instability.²⁴⁵ Common alternatives for independent agencies are dedicated funding from the regulated industry in one of two ways, either assessments of the regulated industry—for example, dedicating the private foundation investment income excise collections for the agency—or fees for services (such as the existing application fee).²⁴⁶ The latter approaches can both create stability and protect the agency from political interference, but are only available if Congress is willing to authorize them and thereby surrender this means of influencing the agency. Self-funding also may increase presidential influence, particularly as exercised through the appointment process, as compared to congressional influence.²⁴⁷

At the same time, such a departure may leave certain advantages behind. Even with its battered reputation, a letter from the IRS has an *in terrorem* effect that a new agency would be hard-pressed to duplicate. As part of the IRS, the exempt organization function also receives support in numerous ways from other parts of the federal government that would have to either remain available to the new agency or be transferred to it.²⁴⁸ At first glance, neither of these disadvantages appears particularly strong, however, especially since maintaining existing support (e.g., IRS service center processing of forms, the Department of Justice Tax Division's litigation support) or assuming it (e.g., hiring in-house attorneys to provide legal support in place of IRS Chief Counsel) appears to be achievable.

Certain restrictions would continue to apply, however, including civil service rules and compensation levels that may inhibit the ability of the new agency to hire and retain qualified personnel.²⁴⁹ Similarly, procurement rules may limit the ability of the new

²⁴² See Helge, *supra* note 97, at 25; Kristin E. Hickman, *Administering the Tax System We Have*, 63 DUKE L.J. 1717, 1733-35 (2014); Owens, *supra* note 58, at 5-7.

²⁴³ See *supra* note 1.

²⁴⁴ See JCT 2000 REPORT, *supra* note 23, at 120 (EO Division budget of \$61.7 million in fiscal year 1999).

²⁴⁵ See ASHLEY C. BROWN, THE FUNDING OF INDEPENDENT REGULATORY AGENCIES: A SPECIAL REPORT TO THE PUBLIC UTILITIES COMMISSION OF ANGUILLA 7 (2008), <http://www.hks.harvard.edu/hepg/Papers/AnguillaPUC.pdf> [<http://perma.cc/HM8P-R4ZQ>]; Joel Seligman, *Self-Funding for the Securities and Exchange Commission*, 28 NOVA L. REV. 233, 253-54 (2004); Note, *Independence, Congressional Weakness, and the Importance of Appointment: The Impact of Combining Budgetary Autonomy with Removal Protection*, 125 HARV. L. REV. 1822, 1825-29 (2012).

²⁴⁶ See BROWN, *supra* note 245, at 4, 8; Seligman, *supra* note 245, at 254-55.

²⁴⁷ See Note, *supra* note 245, at 1839.

²⁴⁸ See *supra* note 32 and accompanying text.

²⁴⁹ See FREMONT-SMITH, *supra* note 8, at 392; BROWN, *supra* note 245, at 13-14; Owens, *supra* note 58, at 5.

agency to obtain needed technology and outside expertise in the form of consultants.²⁵⁰ Perhaps most importantly, it is not clear to what extent Congress would fund any new agency, particularly in these budget-conscious times.²⁵¹ Finally, careful consideration would also have to be given regarding what portions of the Internal Revenue Code would become subject to the interpretation and enforcement of the new agency and what portions would remain with the IRS to minimize overlap and the resulting need for coordination.²⁵²

2. *Leaving the Federal Government*

The type of SRO proposed by Owens is one that would have mandatory (as opposed to voluntary) membership for all exempt (or at least charitable) organizations and would wield implementation and enforcement authority (including the ability to impose direct sanctions, unlike most private accrediting bodies).²⁵³ The academic literature relating to SROs indicates there are four threshold requirements for successful execution of this type of SRO's regulatory role. First, the regulated community must support both the creation of the SRO and regulation by that SRO in the public interest, including through needed enforcement.²⁵⁴ Second, the SRO must be able to apply legally enforceable sanctions to members of the regulated community who violate the applicable rules.²⁵⁵ Third, the SRO must be able to secure sufficient resources, both in terms of funding and staff expertise, to fulfill its assigned role.²⁵⁶ Fourth, the government agency overseeing the SRO must have sufficient resources, including expertise, and incentives to be effective as an overseer.²⁵⁷

The exempt organizations area appears to satisfy all four of these threshold requirements. As already noted, exempt organizations, and particularly charities, generally have a strong interest in regulation that promotes the public's interest in ensuring such entities satisfy the legal requirements for the tax benefits they receive.²⁵⁸ By conditioning tax exemption and, for charities, the ability to receive tax deductible contributions on being a member in good standing of the SRO and giving the SRO authority to enforce in court

²⁵⁰ See BROWN, *supra* note 245, at 13-14.

²⁵¹ See JCT 2000 REPORT, *supra* note 23, at 120 (EO Division budget of \$61.7 million in fiscal year 1999); Joseph Bankman & Paul L. Caron, *California Dreamin': Tax Scholarship In A Time of Fiscal Crisis*, 48 U.C. DAVIS L. REV. 405, 406-08 (2014).

²⁵² See generally Alejandro E. Camacho & Robert L. Glicksman, *Functional Government in 3-D, A Framework For Evaluating Allocations Of Government Authority*, 51 HARV. J. ON LEGIS. 19 (2014).

²⁵³ See Jody Freeman, *Private Parties, Public Functions and the New Administrative Law*, 52 ADMIN. L. REV. 813, 831-38 (2000); Douglas C. Michael, *Federal Agency Use of Audited Self-Regulation as a Regulatory Technique*, 47 ADMIN. L. REV. 171, 174-81 (1995); Saule T. Omarova, *Wall Street as Community of Fate: Toward Financial Industry Self-Regulation*, 159 U. PA. L. REV. 411, 424 (2011); *supra* notes 233-234 and accompanying text.

²⁵⁴ See, e.g., Onnig H. Dombalagian, *Self and Self-Regulation: Resolving the SRO Identity Crisis*, 1 BROOK. J. CORP. FIN. & COM. L. 317, 323 (2007); Neil Gunningham & Joseph Rees, *Industry Self-Regulation: An Institutional Perspective*, 19 L. & POL'Y 363, 391 (1997); Michael, *supra* note 253, at 192-93, 243-44; Omarova, *supra* note 253, at 446-47.

²⁵⁵ See, e.g., THE NAT'L CTR. ON PHILANTHROPY & THE L., STUDY ON MODELS OF SELF-REGULATION IN THE NONPROFIT SECTOR 11 (2005), <http://www1.law.nyu.edu/ncpl/pdfs/Self%20Regulation%20Final%20Report-040307updates.pdf> [<http://perma.cc/XNX2-63TG>] [hereinafter NCPL REP.]; Omarova, *supra* note 253, at 445-46; Mark Sidel, *The Guardians Guarding Themselves: A Comparative Perspective on Nonprofit Self-Regulation*, 80 CHI.-KENT L. REV. 803, 812-13 (2005).

²⁵⁶ See, e.g., NCPL REP., *supra* note 255, at 12; Michael, *supra* note 253, at 243.

²⁵⁷ See, e.g., Michael, *supra* note 253, at 195; Derek Fischer, Note, *Dodd-Frank's Failure to Address CFTC Oversight of Self-Regulatory Organizations Rulemaking*, 115 COLUM. L. REV. 69, 89-95 (2015).

²⁵⁸ See *supra* note 98 and accompanying text.

any sanctions imposed for violations of the applicable rules, Congress can satisfy the second requirement.²⁵⁹ Through the same mechanism, Congress can ensure that all organizations enjoying these federal tax benefits provide financial support to the SRO, which the SRO could use in turn to hire staff with the necessary expertise.²⁶⁰ The federal government currently collects from private foundations an amount that is two or more times the IRS Exempt Organizations Division budget through a very modest (no more than two percent) excise tax on investment income, so it should be an easy matter to construct a sliding scale dues structure that provides sufficient financial resources without unduly burdening the regulated community.²⁶¹ Finally, the IRS has spent decades developing expertise in this area that could be deployed to provide the necessary government oversight. Its still-healing scars from the latest exempt organizations oversight failure should also provide sufficient incentive to provide adequate supervision of the SRO.²⁶²

That said, moving the exempt organization function entirely out of the federal government to a self-regulatory body raises additional advantages and disadvantages, while sharing some but not all of the advantages and disadvantages of a new federal agency. The most important new advantage is the ability to generate financial support outside of the federal budget process.²⁶³ While some of the funding options discussed previously for a new agency could make that agency's funding less vulnerable to political interference, an SRO would have greater separation from the political branches.²⁶⁴ Another new advantage is freedom from civil service rules, which would permit the SRO to pay higher levels of compensation and more easily hire (and fire) employees than either the IRS or a new federal agency.²⁶⁵ Unlike a federal agency, a sufficiently private body would not be subject to constitutional restrictions on its activities or the Administrative Procedure Act, giving it more flexibility.²⁶⁶ At the same time, however, it is necessary to both limit constitutional challenges and bolster the legitimacy of the SRO by providing some level of due process and transparency.²⁶⁷ Finally, a self-regulatory body with significant involvement by nonprofit organization leaders may result in greater cooperation between the regulator and the regulated community as well as greater regulated community buy-in, participation, and compliance.²⁶⁸ The reduced government involvement may also attract more political support for strong oversight.²⁶⁹

²⁵⁹ See Helge, *supra* note 97, at 76; Owens, *supra* note 58, at 21; see also Jonathan Macey & Caroline Novogrod, *Enforcing Self-Regulatory Organization's Penalties and the Nature of Self-Regulation*, 40 HOFSTRA L. REV. 963, 998-1000 (2012) (mere expulsion from membership is only an effective sanction if the SRO has sufficient market power).

²⁶⁰ See Helge, *supra* note 97, at 73; Owens, *supra* note 58, at 23.

²⁶¹ See Helge, *supra* note 97, at 73-74; Owens, *supra* note 58, at 2-3.

²⁶² See *supra* note 1.

²⁶³ See *supra* notes 260-261 and accompanying text.

²⁶⁴ See *supra* note 246 and accompanying text.

²⁶⁵ See Helge, *supra* note 97, at 26-27; Owens, *supra* note 58, at 24; see also CENTER FOR THE STUDY OF DEMOCRATIC INSTITUTIONS, SURVEY ON THE FUTURE OF GOVERNMENT SERVICE EXECUTIVE SUMMARY 2 (2015), <http://www.vanderbilt.edu/csdi/research/sfgs.php> [<http://perma.cc/77JL-C5Y2>] (rigid civil service rules and low salaries contribute to difficulties in recruiting the best employees).

²⁶⁶ See Dombalagian, *supra* note 254, at 340 & n.102; Owens, *supra* note 58, at 14-15. See generally Kristin E. Hickman, *Unpacking the Force of Law*, 66 VAND. L. REV. 465 (2013) (administrative law limits on tax administration).

²⁶⁷ See Omarova, *supra* note 253, at 485-86; Owens, *supra* note 58, at 21.

²⁶⁸ See Helge, *supra* note 97, at 80-81; Michael, *supra* note 253, at 183-84.

²⁶⁹ See Michael, *supra* note 253, at 184-88.

With respect to disadvantages, an SRO would not be able to directly impose criminal sanctions, but such sanctions are rarely used in the exempt organizations area and could still be accessible indirectly through referrals to the IRS Criminal Investigation Division.²⁷⁰ SROs also usually have a significant risk of inadequate oversight because of capture by the regulated community (or dominant players within that community), a risk that also exists with a separate federal agency but may be magnified with a private body that has closer formal and informal ties to the regulated industry.²⁷¹ In this context, however, the regulated industry leaders (and particularly prominent charities) likely are more amenable to having a strong and effective regulator than normally is the case for regulated communities because of their interest in the reputation of the exempt organization sector.²⁷² In fact, one potential risk of an SRO is that if it is dominated by the largest and wealthiest tax-exempt organizations with a strong interest in preventing noncompliance, it could create a risk of over regulation that would unduly burden smaller, poorer, and less sophisticated organizations.²⁷³ For example, the move of the IRS toward regulating governance, criticized in part because of the potential for ill-fitting one-size-fits-all rules, could be accelerated in an SRO dominated by leaders of the largest and wealthiest organizations (and encouraged by SRO officials seeking to increase their sphere of authority).²⁷⁴ Such a risk could be mitigated by sufficient involvement of representatives from smaller and less well-resourced exempt organizations and, as suggested by Owens, by not giving the SRO the ability to impose rules that went beyond those necessary to ensure compliance with the applicable federal tax laws.²⁷⁵ Another potential disadvantage is the reduced influence of the federal government and the public on the interpretation of statutory provisions, possibly leading those interpretations to be less responsive to political pressures than may be desirable.²⁷⁶ The IRS' role likely could be adjusted to address this concern if it arose, however (as has happened with the SEC and the SROs it oversees).

It is also unclear as to what extent a private body, even one with close ties to the federal government, could continue to benefit from various government support functions, but it may be possible to still take advantage of at least some of that support, especially to the degree it is essentially ministerial (e.g., processing filings). Finally, a new SRO might also face a constitutional challenge to its authority.²⁷⁷ That said, the constitutional questions generally relate either to a lack of clear legislative approval, a lack of sufficient

²⁷⁰ See TREASURY INSPECTOR GENERAL FOR TAX ADMIN., IE-09-013, REVIEW OF THE INTERNAL REVENUE SERVICE CRIMINAL INVESTIGATION DIVISION'S NONPROFIT FRAUD REFERRAL PROCESS 6-8 (2010), <https://www.treasury.gov/tigta/iereports/2010reports/2010IER006fr.pdf> [<https://perma.cc/NY3Y-CNA>].

²⁷¹ See Michael, *supra* note 253, at 189-90; Owens, *supra* note 58, at 11-12.

²⁷² See *supra* note 98 and accompanying text.

²⁷³ See Gabriel S. Mairzadeh, *Self-Regulation of Investment Companies and Advisers: A Proven Solution to a Contemporary Problem*, 16 ANN. REV. BANKING L. 451, 507-08 (1997) (highlighting this issue with respect to securities law SROs).

²⁷⁴ See Bonnie S. Brier et al., *The Appropriate Role of the Internal Revenue Service With Respect To Tax-Exempt Organization Good Governance Issues*, in ADVISORY COMMITTEE ON TAX EXEMPT AND GOV'T ENTITIES, REPORT OF RECOMMENDATIONS 43-44 (2008).

²⁷⁵ See Owens, *supra* note 58, at 19-20; see also Mayer & Wilson, *supra* note 219, at 534-39 (recommending an enhanced state role in overseeing charity governance as opposed to a federal or self-regulatory approach).

²⁷⁶ See Michael, *supra* note 253, at 190-91.

²⁷⁷ See generally Harold I. Abramson, *A Fifth Branch of Government: The Private Regulators and Their Constitutionality*, 16 HASTINGS CONST. L.Q. 165 (1989); Alexander Volokh, *The New Private-Regulation Skepticism: Due Process, Non-Delegation, and Antitrust Challenges*, 37 HARV. J.L. & PUB. POL'Y 931 (2014).

due process, or a lack of sufficient government oversight.²⁷⁸ It therefore should be possible to properly construct an SRO and its processes such that it should survive any such constitutional scrutiny.

An SRO therefore appears to be a viable option and most of the disadvantages of leaving the federal government appear relatively minor in the context of the exempt organization function. Furthermore, the advantages of leaving the federal government appear significant, particularly with respect to the ability to access greater resources and escape ill-fitting civil service and revenue-collection related rules.

There is, however, one important caveat. Most examples of national SROs wielding substantial authority in cooperation with a federal agency occurred in situations where the federal government was taking on a new regulatory responsibility and choose from the beginning to house that responsibility primarily in one or more SROs.²⁷⁹ In contrast, the regulation of exempt organizations through the federal tax laws is a longstanding and relatively mature regulatory role. Moving that role to an SRO now could therefore raise certain additional concerns. For example, the IRS has almost 900 employees currently dedicated to exempt organization matters, and some of the support functions such as Chief Counsel also have a significant number of dedicated exempt organization employees.²⁸⁰ If the exempt organization function moved to a new federal agency, it might reasonably be expected that many of those employees, and particularly the ones with the greatest experience and expertise, could also be persuaded (or possibly required if they wanted to remain employed by the government) to move to that agency. Such an expectation seems less reasonable, however, if that function were to move to a private body that does not offer the same level of job security or benefits (including union representation) as a federal government position.²⁸¹ Particularly, given this concern, it is far from clear how quickly a new SRO could staff up even with the aid of existing, voluntary self-regulatory bodies such as Independent Sector, which in turn could lead to it falling behind in the processing of the close to 90,000 applications and the hundreds of thousands of returns filed annually, not to mention the dozens of current guidance projects and other less formal education initiatives.²⁸² While there are some existing organizations that develop and promulgate best practices and in some instances even provide certifications, none of them has developed to anywhere near the scale required to oversee all exempt organizations (or even all charities).²⁸³

It would also take a major educational effort to familiarize the over a million existing exempt organizations, the millions of individuals who serve in leadership roles with such groups, and the numerous professionals that advise those organizations with the new regulatory structure. For example, despite years of effort to communicate with smaller exempt organizations about the looming risk of automatic revocation, tens of thousands of such organizations apparently missed the message.²⁸⁴ And because such a shift appears to

²⁷⁸ See Volokh, *supra* note 277, at 950, 960.

²⁷⁹ See Michael, *supra* note 253, at 203-240.

²⁸⁰ See JCT 2000 REPORT, *supra* note 23, at 117-19; *supra* note 24 and accompanying text.

²⁸¹ See NAT'L TREASURY EMPLOYEES UNION, ABOUT NTEU, <http://www.nteu.org/NTEU> [<http://perma.cc/D4R9-YC8B>].

²⁸² See *supra* Parts II.B. to II.D.; *supra* notes 229-230 and accompanying text.

²⁸³ See, e.g., BBB WISE GIVING ALLIANCE, <http://www.give.org> [<http://perma.cc/J7MW-4Y9U>]; CHARITY NAVIGATOR, <http://www.charitynavigator.org> [<http://perma.cc/XN9F-QPXQ>]; *supra* notes 229-230 and accompanying text.

²⁸⁴ See TREASURY INSPECTOR GENERAL FOR TAX ADMIN., 2012-10-027, APPROPRIATE ACTIONS WERE TAKEN TO IDENTIFY THOUSANDS OF ORGANIZATIONS WHOSE TAX-EXEMPT STATUS HAD BEEN

be unprecedented, there are almost certainly other transition issues that would not be identified until after the transition was ongoing. These identified and unknown risks are not necessarily fatal to the proposal to shift the exempt organization function to a private, self-regulatory body, but they strongly suggest further thought and research needs to be devoted to developing and planning for them before moving in this direction, as attractive as it may otherwise appear.

There also are numerous implementation issues, some of which Owens addresses in his proposal.²⁸⁵ They include what functions would shift to the SRO with respect to application processing, examinations and other compliance initiatives, rulemaking and other guidance, and policy setting. They also include whether the functions should be transferred over a period of time, both in order to better address the challenges of moving a mature regulatory role out of the federal government and to permit systematic evaluation of whether the transfer of each function has had positive results, and, if so, on what timetable. Relatedly, Congress would need to determine the continuing role of the IRS and the Treasury Department with respect to the transferred functions. Also, the above discussion assumed there would be a single SRO (with a broadly representative board), but it might make sense to instead have multiple SROs, each covering distinct types of exempt organizations (e.g., schools, hospitals). Congress would also need to determine the extent of the SRO's immunity from liability, both generally and with respect to antitrust laws specifically.²⁸⁶

Again, none of these questions necessarily raise fatal issues. They do, however, indicate how complicated and difficult shifting regulation of exempt organizations from the IRS to a non-governmental body likely would be. Nevertheless, the increasing failure of IRS oversight detailed in Part II of this Article, the limited ability to improve that oversight given likely available resources described in Part III, and the potential benefits of moving the locus of exempt organization oversight to an SRO formed along the above lines all support pursuing development of such an entity.

V. CONCLUSION

The IRS oversight of exempt organizations with respect to their compliance with applicable federal tax laws has reached a breaking point. Absent significant changes, the public's confidence both in the ability of the IRS to provide such oversight and in the good behavior of exempt organizations themselves will almost certainly continue to decline. And that decline may soon reach a point, if it has not already, that threatens both the IRS's ability to fulfill its primary, revenue-collecting responsibilities and the public support on which most exempt organizations rely.

Even with its current resources and with no changes in the applicable substantive law, there are several ways in which the IRS could improve its oversight of exempt organizations. These ways include continuing to use streamlined application procedures, increasing the efficiency of the examination process, ensuring greater disclosure of relevant information, and expanding electronic filing requirements. Particularly if enacted together and carefully evaluated and recalibrated as necessary to maximize their impact on compliance, these methods have the potential to help the IRS do more with less.

AUTOMATICALLY REVOKED, BUT IMPROVEMENTS ARE NEEDED (2012), <https://www.treasury.gov/tigta/auditreports/2012reports/201210027fr.html> [<https://perma.cc/R8HP-5VEA>]; *supra* note 42 and accompanying text.

²⁸⁵ Owens, *supra* note 58, at 18-24; *see also* Helge, *supra* note 97, at 70-79.

²⁸⁶ *See* Michael, *supra* note 253, at 198-203.

But given the resource constraints faced by the IRS and the continuing growth of the exempt organization sector, it is unlikely that these methods will be sufficient to attain an acceptable level of oversight for exempt organizations. The time is therefore ripe to consider bolder but riskier proposals to shift the oversight of exempt organizations outside of the IRS. While a new federal agency has certain advantages, a new self-regulatory body that operates under the close supervision of the IRS appears to be a significantly better candidate for obtaining funding and freedom needed to substantially increase this oversight and therefore compliance with the federal tax laws applicable to exempt organizations. While the risks of moving this mature regulatory role out of the federal government are substantial and not completely known, such that any such move would require careful consideration of what functions would move out of the IRS, how such a transition would be sequenced, and how it would be evaluated, it is time to pursue this option.