

## **IRS problem started with vague tax exemption rules**

**IRS was ill-equipped to handle the deluge of tax-exempt applications from 'social welfare' organizations and to police their political activities, experts say.**

By Matea Gold, Washington Bureau

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WASHINGTON — In spring 2010, agents in the Cincinnati office of the Internal Revenue Service, which handles applications for tax-exempt status, faced a surge of filings by new advocacy groups, with little guidance on how to treat them.

Their decision to deal with the problem by singling out tea party and other conservative groups for extra scrutiny has now triggered a criminal inquiry, congressional investigations, the departure of two top IRS officials and the naming of a new acting commissioner Thursday.

For former IRS staff and tax experts, the case confirms what they view as one of the agency's long-standing weaknesses: its inability to cope with the growing number of tax-exempt advocacy groups that appear to stretch the law to engage in politics.

With the IRS now under fire for its practices, campaign finance lawyers anticipate that the agency will shy away even more from regulating such organizations.

At the heart of the issue is the murky role occupied by nonprofit "social welfare" organizations, set up under Section 501(c)4 of the tax code, which are allowed under IRS regulations to engage in a certain amount of campaign activity, as long as politics is not their "primary" purpose. The groups pay no tax on the money they bring in. They can accept unlimited donations and, unlike political committees, can keep their contributors secret.

That status became especially valuable three years ago with the Supreme Court's decision in the Citizens United case, which lifted the ban on direct campaign spending by corporations, including many nonprofit groups. The ruling triggered the boost of applicants to the IRS.

The stepped-up role of tax-exempt groups in politics has stymied the Federal Election Commission, which has deadlocked on questions about how much disclosure is required of advocacy organizations that engage in elections.

That has left much of their regulation in the hands of the IRS, which has never clearly defined how much political activity is allowed for social welfare organizations.

The vagueness of the law may have contributed to the problems, President Obama said Thursday in his response to the controversy. Congress and his administration need to "look at some of the laws that create a bunch of ambiguity in which the IRS may not have enough guidance," he said.

The IRS' Cincinnati office, in trying to determine which applicants for tax exemption might have politics as their primary purpose, inappropriately singled out groups with "tea party" or similar words in their paperwork, according to an inspector general's report released Tuesday. Some of the staff handling the applications were confused about what is permitted, the report said. The situation underscored how ill-equipped the agency is to deal with its regulatory charge, campaign finance experts said.

"The IRS does not have the competence or the expertise to be policing the political activities of tax-exempt organizations," said Robert Kelner, a Washington campaign finance lawyer who heads the political law practice at Covington & Burling. "So even in the best of worlds, with the best of interests, it's a fool's errand to expect the IRS to be able to accomplish this task."

Campaign finance reform advocates and congressional Democrats have pushed the IRS to rein in what they see as an abuse of tax-exempt status. Nonprofit advocacy groups and trade organizations on both the left and right reported spending \$309 million on campaigns in 2012, according to the nonpartisan Center for Responsive Politics. The true amount was much greater, as such groups have to report only a fraction of their spending.

The storm now engulfing the IRS "is going to make it harder and not easier" to get effective enforcement, said Ellen P. Aprill, a tax law professor at Loyola Law School.

That troubles backers of stricter enforcement, who note that although IRS staff investigated the workings of dozens of small tea party groups around the country, it is unclear whether they scrutinized the major organizations that spent tens of millions of dollars to influence the 2010 and 2012 elections. The inspector general's report said the IRS had failed to flag an estimated 185 groups that had indications of "significant political campaign intervention."

"We're getting sidetracked on the wrong issue; the much bigger problem is the failure of the IRS to get 501(c)4s under control," said Melanie Sloan, executive director of Citizens for Responsibility and Ethics in Washington, which has sued the agency over its lack of enforcement.

Others argue that such supervision should not be the mission of the IRS.

"Of all agencies, do we want the IRS to be the ones to regulate political speech?" asked Howard Gleckman, a resident fellow at the Urban Institute, who writes and edits a blog on tax policy.

When it was created 100 years ago, the social welfare tax exemption was aimed primarily for civic groups and beautification committees, not political vehicles, experts said. The tax code says such groups must operate "exclusively" to promote the common good and general welfare of the community. But IRS regulations dating to 1959 allow such groups to engage in some political activity, as long as politics is not the organization's primary purpose.

To determine whether a social welfare group engages too heavily in politics, the IRS relies on a subjective "facts and circumstances" test, which requires agency staff to rely heavily on their own judgment and experience. The official IRS manual offers tax agents only a template letter outlining the process of asking a group for more information, but does not specify what questions to ask, according to an April 2012 letter that Lois Lerner, director of tax-exempt organizations, sent to a House committee.

"It's a really hard line to figure out," said Philip Hackney, an assistant law professor at Louisiana State University who worked as a lawyer in the IRS' Office of Chief Counsel from 2006 to 2011. "The problem is that you're working with the motivations of people."

The agency had historically not focused much attention on 501(c)4 applicants, Hackney said, training most of its

scrutiny instead on groups attempting to take advantage of charity status, which is governed by a separate section of the tax code. "We were struggling to figure out what to do about them," he said.

Then came the Citizens United ruling in 2010. That year, 1,735 groups applied for 501(c)4 status — a figure that nearly doubled by 2012, according to the inspector general's audit. As tax agents tried to juggle the workload, top IRS officials realized many did not understand what kind of political activity was allowed and held two days of workshops in May 2012 to train the staff. The agency told the inspector general that it now plans to develop guidance on how to measure the primary activity of an organization.

The decision by agents in Cincinnati to flag groups that appeared to have a conservative ideology was "very bad," said Brett Kappel, a campaign finance lawyer at the firm Arent Fox in Washington. "But I don't think it was politically motivated; I think it's incompetence."

In some ways, the fact that the IRS bungled this task is not surprising, Kappel said: "Their core mission is to collect taxes, not to regulate political speech."

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