

WRITTEN TESTIMONY OF MARCUS S. OWENS
BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON OVERSIGHT ON
“HOW THE TAX CODE SUBSIDIZES HATE”
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I. Introduction

Chairman Lewis, Ranking Member Kelly, and members of the Subcommittee, thank you for the opportunity to appear before you today to discuss the Internal Revenue Code (“Code”) and, as you put it, the subsidization of hate speech. I am a partner in the Washington, DC office of the law firm of Loeb & Loeb, LLP. However, for 25 years, from 1975 until 2000, I was employed in the Exempt Organizations Division of the Internal Revenue Service and from 1990 until 2000, I served as Director of that Division. The Exempt Organizations Division during that 25-year period had responsibility for the administration of the provisions of the Code dealing with tax-exempt organizations, including public charities and private foundations described in section 501(c)(3) of the Code, social welfare organizations described in section 501(c)(4) of the Code, and entities described in what now total 29 different subsections under section 501(c). In addition, the Division had responsibility for the penalty excise taxes on private foundations, the excess benefits excise tax applicable to public charities, tax issues related to political organizations described in section 527 of the Code and, after 1993, tax-exempt bonds.

The largest number of tax-exempt organizations, then and now, are found in section 501(c)(3). The organizations in that group touch the lives of virtually all citizens and residents of the United States through the critical roles that the organizations play in religion, education, healthcare and

social services. The administration of the Code's provisions that apply to those organizations is housed in the Internal Revenue Service, however, the Service's core mission, and the focus of the vast majority of the agency's employees and resources, is to collect the revenue necessary to fund the federal government, an effort that is intensely focused on the advanced parsing of accounting data. In contrast, the process of administering the tax laws that apply to tax-exempt organizations, seemingly itself a contradiction in terms, requires the agency to grapple with complex, near-philosophical issues such as what constitutes a church, whether a private school is racially-discriminatory and how the for-profit practice of medicine differs from the provision of medical care in a non-profit, tax-exempt structure and the focus of this hearing: the standards for status as an educational organization entitled to tax-exempt status within the meaning of section 501(c)(3).

II. Tax-Exempt Status as an Educational Organization

In describing the basis for tax-exempt status for educational organizations, and charities more generally, it is important to understand that while much of the current language in the Code describing such groups dates from no earlier than 1913, with predecessor iterations appearing in several earlier tariff acts, the standards have roots that are at least 500 years old, resting deep in English legal history. In fact, the language used in Treasury Regulations further describing the attributes of charity status in section 501(c)(3), which were issued in 1969,¹ bears a striking similarity to the cadence of the Preamble of the Statute of Charitable Uses enacted by the English Parliament in 1601. It thus comes as no surprise that when the U. S. Supreme Court, in the case

¹ Treas. Reg. §1.501(c)(3)-1(d)(3)(i).

of Bob Jones University v. United States,² analyzed the issue of whether private schools that practiced racial discrimination in their educational activities were entitled to tax-exempt status, the Court reached back to those English roots for guidance and concluded that actions violating law or clearly defined public policy are not entitled to tax-exempt status.

The statutory basis in the Internal Revenue Code for tax-exemption for educational organizations is a model of brevity: it consists of the single word “educational, appearing in a list of other descriptors of tax-exempt behavior in section 501(c)(3) of the Code. The statute is silent on the nature of what actually constitutes educational activity, and it contains no direct, indirect, oblique or inferred reference to the content of the communications that might constitute educational speech.

As I noted above, the Treasury Department issued regulations providing a more detailed description, including an effort to define educational speech that would support tax-exempt status for an organization and non-educational speech that would not. That effort appears in Treasury Reg. §1.501(c)(3)-1(d)(3)(i) which provides that the term “educational” in section 501(c)(3) relates to two types of activities: the instruction or training of the individual for the purpose of improving or developing his capabilities, or the instruction of the public on subjects useful to the individual and beneficial to the community. The regulation further notes that “an organization may be educational even though it advocates a particular position or viewpoint so long as it presents a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion.” The regulation also provides that “an organization is not educational if its principal function is the mere presentation

² 461 U.S. 574 (1983).

of unsupported opinion.” Note that the regulation does not prohibit any form of speech, but rather attempts to distinguish the type of speech or communication that would support tax-exempt status from that which would not, drawing a distinction between what is commonly known as “hate speech” and commercial marketing communications from educational speech. The distinction between educational speech and commercial or marketing speech was ratified in a unanimous U. S. Supreme Court decision regarding the tax treatment of advertising revenues in United States v. American College of Physicians.³

The IRS experience in applying the distinctions made in the Treasury Regulations has been the subject of litigation. In Big Mama Rag, Inc. v. United States,⁴ the Circuit Court for the District of Columbia held that Treas. Reg. §1.501(c)(3)-1(d)(3) was unconstitutionally vague. Several years later in National Alliance v. United States,⁵ the same Court upheld the revocation of tax-exempt status of an organization on the grounds that it was not educational. In the National Alliance decision, the Court noted that the IRS focus on the methodology used to develop communications “tend[s] toward ensuring that the educational exemption be restricted to material which substantially helps a reader or listener in a learning process,” and that reduced the vagueness found in Big Mama Rag.

In order to provide guidance to IRS employees and the public in the wake of the two decisions, in 1986, the IRS issued Revenue Procedure 86-43, building on the “methodology” standard referenced in National Alliance to assist in determining whether advocacy by an organization is

³ 475 U.S. 834 (1986).

⁴ 631 F.2d 1030 (D.C. Cir. 1980).

⁵ 710 F. 2d 868 (D.C. Cir. 1983).

educational within the meaning of section 501(c)(3) of the Code. In the revenue procedure, the IRS states that although it “renders no judgment as to the viewpoint or position” of an organization, it will look to the method used by the organization to develop and present its views. The revenue procedure goes on to observe that “the method used by the organization will not be considered educational if it fails to provide a factual foundation for the viewpoint or position being advocated, or if it fails to provide a development from the relevant facts that would materially aid a listener or reader in a learning process.” The revenue procedure also sets forth four factors that are indicative that the method used by an organization is not educational:

1. The presentation of viewpoints or positions unsupported by facts is a significant portion of the organization’s communications.
2. The facts that purport to support the viewpoints or positions are distorted.
3. The organization’s presentations make substantial use of inflammatory and disparaging terms and express conclusions more on the basis of strong emotional feelings than of objective evaluations.
4. The approach used in the organization’s presentations is not aimed at developing an understanding on the part of the intended audience or readership because it does not consider their background or training in the subject matter.

The revenue procedure concludes that there may be exceptional circumstances where a communication may still be considered educational despite the presence of one or more of the factors.

The revenue procedure was utilized by the Tax Court to reach its conclusion in Nationalist Movement v. Commissioner,⁶ that the organization did not qualify as educational based on its frequent use of inflammatory statements, including ethnic, racial and religious slurs in its communications, coupled with distorted statements presented as fact. On appeal, the Fifth Circuit upheld the Tax Court, concluding that the organization's activities were sufficient to defeat tax-exempt status without requiring the Court to consider the revenue procedure.⁷

III. The Premise of the Hearing: How the Tax Code Subsidizes Hate

As I have noted above, it is my opinion that the provisions of the statute in question, section 501(c)(3) of the Internal Revenue Code, neither subsidize hate speech nor prohibit it. The statute is silent on that point. The regulations interpreting the section 501(c), while not coming to grips with hate speech, set forth a standard that categorizes speech as educational and non-educational, taking the position that the presentation of mere statements of opinion do not constitute educational speech. Revenue Procedure 86-43, issued in the wake of the Big Mama Rag and National Alliance decisions, sets out an approach to addressing the tax status of non-educational speech, particularly speech that falls within the realm of hate speech. While the revenue procedure's approach is not perfect and, as with all speech-related government standards, there is a potential for First Amendment challenges, the approach has withstood judicial scrutiny.

Having a standard, however, accomplishes little unless accompanied by an effort at enforcement. While a few examples exist of Revenue Procedure 86-43 being used in the processing of applications for tax-exempt status, there is virtually no information regarding the extent to which

⁶ 102 T.C. 558 (1994).

⁷ 37 F. 3d 216 (1994).

the Revenue Procedure is utilized in IRS examinations of organizations after tax-exempt status has been recognized. Indeed, the data reported in the IRS Data Book for fiscal year 2018 reflects that the IRS received 1,603,499 returns from tax-exempt organizations that year.⁸ The same Data Book, however, reports that only 2,816 returns of the same types included in the number filed were examined. While there are certainly concerns with the comparability of the two sets of numbers, 2,816 returns examined reflects a very small percentage of the universe of organizations filing returns, particularly when some unidentified number are Form 990-N filings made by very small organizations. The small number of actual examinations of tax-exempt organizations undoubtedly reflects resource allocation decisions within the IRS that ensure that the core mission of the IRS, tax collection to fund the government, continues, with those functions not generating significant tax revenue, as is the case with tax-exempt organizations, receiving reduced resources. The reduced resources have resulted in the consolidation of operational units and various technical functions, with a risk of dilution of institutional knowledge and a reduced flow of information about the tax-exempt sector to senior managers and policy makers in Washington, DC.

Historically, IRS oversight of tax-exempt organizations began with the application process in which organizing documents and operational plans were reviewed in advance of approving tax-exempt status. With the advent of the Form 1023-EZ, or limited scope application, most new organizations receive tax-exempt status in a virtual registration system, without significant scrutiny of their operations. For those organizations that care to avoid even that level of front-end scrutiny, it appears that a “secondary market” of some unknown dimension has emerged in

⁸ Table 2, Number of Returns and Other Forms Filed, by Type, Fiscal Years 2017 and 2018.

which dormant organizations are maintained in active status and later resurrected with a new name and new officers and directors. While that approach comports with current law and procedure, it does circumvent any “up front” review by the IRS; it appears to be the procedure followed by white supremacist Richard Spencer and the National Policy Institute, Inc. A review of Form 990 returns filed by the reflect that the National Policy Institute is using an employer identification number (“EIN”) that in 1997 was being used by an organization called the Institute for Free Enterprise Development. It appears that the 1997 Form 990 was the last one filed by the Institute for Free Enterprise Development and the financial data it reports reflects a spending down of its assets. Later, the same EIN reappears in on a 2005 Form 990 filed by the National Policy Institute, now equipped with different officers and directors. In short, the National Policy Institute used the “secondary market” to minimize any scrutiny that the filing of an application for tax-exempt status would have provided.

V. Conclusion

In summary, while the Internal Revenue Code is silent on standards for speech, the Treasury Department and the IRS have endeavored to craft guidance that comports with the First Amendment while minimizing the use of tax-exempt organizations as vehicles for the promulgation of hate speech. The ability of the IRS to enforce those standards, however, has been steadily degraded over the last decade to the point where it appears unlikely that enforcement of federal tax rules applicable to tax-exempt organizations with regard to any issue is increasingly rare.

Chairman Lewis, Ranking Member Kelly, and the members of the Subcommittee, I appreciate the opportunity to testify on this important topic and would be happy to take your questions.

