

STATEMENT FOR THE RECORD

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SENATE JUDICIARY COMMITTEE, SUBCOMMITTEE ON OVERSIGHT,
AGENCY ACTION, FEDERAL RIGHTS AND FEDERAL COURTS

“HEARING ON REVISITING IRS TARGETING:
PROGRESS OF AGENCY REFORMS AND CONGRESSIONAL OPTIONS”

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Chairman Cruz, Senator Coons, and distinguished Members of the Subcommittee, thank you for the opportunity to share the perspectives of Independent Sector as the Subcommittee examines Internal Revenue Service regulation of political activity by tax-exempt organizations.

I serve as the president and chief executive officer of Independent Sector, a national coalition of more than 500 public charities, foundations, and corporate giving programs whose members represent tens of thousands of organizations and individuals working locally, nationally, and globally. Our membership also includes a number of charitable organizations with affiliated 501(c)(4) social welfare organizations.

We envision a world of engaged individuals, robust institutions, and vibrant communities working together to improve lives and the natural world, and strengthen democratic societies. To help create this future, we lead and catalyze the charitable community, partnering with government, business, and individuals to advance the common good.

Importance of the Charitable Sector

Every day, charitable nonprofit organizations, among many other contributions, provide educational and economic opportunities for families in need; work to alleviate poverty and suffering at home and abroad; assist victims of disaster; enhance the cultural and spiritual development of individuals and communities; facilitate scientific advances; and foster worldwide appreciation for the democratic values of justice and individual liberty that are part of the American character.

The charitable sector is also a critical component of the nation's economy. Nearly one in 10 workers in the United States is employed by a nonprofit organization, and with 13.5 million paid workers, we employ more people than the finance and real estate sectors combined. Further, these organizations pay nearly \$670 billion annually in wages and benefits, salaries that support families in communities across America. In 2010, 501(c)(3) organizations paid \$35.2 billion in payroll taxes.¹

¹ National Center for Charitable Statistics (NCCS), the Urban Institute, the Nonprofit Almanac 2012.

The charitable sector's broad community impact and public support is evidenced by the sheer number of people who volunteer with these organizations and the breadth of its funding sources. Millions of Americans make donations each year, collectively providing nearly \$360 billion² to support the work of charitable nonprofit organizations. But charitable donations are only part of what is needed to ensure that the sector's programs and services can continue. More than 52 percent of revenue across the sector is derived from fees paid for services, ranging from tuition and patient care charges to event admission fees. Nearly one-third of nonprofit sector revenue is generated through partnering with all levels of government to deliver programs and services like after-school care, nutrition assistance, and nursing home care for elderly and disabled Americans.³

Good Governance: Importance and Background

Charitable nonprofit organizations understand that continued support from Americans who give of their time – 8.1 billion hours of volunteer service in 2013⁴ – and money – \$358.4 billion⁵ in charitable giving in 2014 – depends upon the high level of public trust in our sector, and that any erosion of that trust will ultimately harm our missions and the people and causes. We are deeply committed to ensuring that public charities and private foundations are governed effectively and transparently, maintain maximum accountability, demonstrate the highest levels of ethical conduct, and fully comply with the law.

Independent Sector has long been at the forefront of efforts to promote good governance and ethical practice among tax-exempt charitable organizations. In October 2004, we convened the Panel on the Nonprofit Sector with the written encouragement of Congressional leaders of both parties. The Panel undertook a comprehensive review of governance and other aspects of nonprofit sector practice in order to develop recommendations for action by Congress, the IRS, and the sector itself that would help charitable organizations maintain the highest possible standards of ethical conduct.

The 24-member Panel conducted extensive outreach to solicit input and comments from the broader charitable community. This outreach included the creation of six committees⁶ that met regularly; phone calls with thousands of participants; two public comment periods; and 15 field hearings that gave more than 2,500 people in communities ranging from Des Moines to Dallas the opportunity to provide input on the Panel's work. The Panel issued a *Final Report to Congress and the Nonprofit Sector* in June 2005, which contained an integrated package of more than 120

² Giving USA: The Annual Report on Philanthropy for the Year 2014 (2015). Chicago: Giving USA Foundation.

³ National Center for Charitable Statistics (NCCS), the Urban Institute, the Nonprofit Almanac 2012. Sources of Revenue for Reporting Public Charities: NCCS calculations of IRS Statistics of Income Division Exempt Organizations Sample (2007); NCCS Core Files (2009); American Hospital Association (AHA) 2009 survey; and the National Health Accounts, produced by CMS.

⁴ Urban Institute, National Center for Charitable Statistics. 2014. "The Non-profit Sector In Brief: Public Charities, Giving, and Volunteering, 2014." Sarah L. Pettijohn. <http://www.urban.org/UploadedPDF/412923-The-Nonprofit-Sector-in-Brief.pdf>

⁵ Giving USA: The Annual Report on Philanthropy for the Year 2014 (2015). Chicago: Giving USA Foundation.

⁶ Expert Advisory Group, Governance and Fiduciary Responsibilities Work Group, Government Oversight and Self-Regulation Work Group, Legal Framework Work Group, Transparency and Financial Accountability Work Group, and Small Organizations Work Group.

recommendations for improvements within the sector, more effective government oversight, and changes in the law.

Many of the Panel's legislative and regulatory recommendations were incorporated into the Pension Protection Act of 2006, widely considered to be the most comprehensive reform of the charitable sector since the 1969 Tax Reform Act. Among the key Panel recommendations adopted by Congress were:

- Doubling the excise taxes for charities, social welfare organizations, private foundations, and exempt organization managers found to be participating in abusive tax shelters;
- Requiring exempt organizations with annual gross receipts less than \$50,000 to file an annual notice with the IRS containing basic contact and financial information;
- Clarifying that assets in donor advised funds may not be used in ways that confer substantial benefits on donor/advisors;
- Removing barriers that prevent information sharing between state charity officials and the IRS; and
- Improving the appraisal process to ensure more accurate deductions for donated property.

Additionally, Panel recommendations were an important part of the nonprofit community's input into the major redesign of the Form 990 subsequently undertaken by the IRS. The IRS worked closely with Independent Sector and conducted extensive outreach to members of the charitable community during the redesign process. Panel recommendations that were ultimately adopted by the IRS or incorporated in the Form 990 redesign included:

- The mandatory revocation of exempt status for organizations that fail to file an appropriate Form 990 for three consecutive years;
- Expanded Form 990 compensation reporting, to include listing names and reporting compensation for the organization's five most highly compensated employees;
- Requiring additional information, including a summary and statement of purpose on the first page, disclosure of which voting board members are independent, and disclosing the total amount of donor advised funds; and
- Asking whether an organization has a written conflict of interest policy.

The IRS's solicitation of input from the tax-exempt sector on the Form 990 redesign did not end with the release of the new form for tax year 2008, which had been designed with substantial input from the community. Indeed, as the IRS has continued working to improve the Form 990, the agency has continued to seek outside input. During a public comment period conducted in 2011 on several issues of concern that had come to the attention of the agency, Independent Sector conducted an online forum to gather input from exempt organizations, and submitted a number of specific recommendations to the IRS, including:

- Revising Part VIII of the Form 990 to better capture the full extent of government revenue received by nonprofit organizations by clarifying that government pay-for-service contracts also qualify as government contributions, and by including lines to record revenue received from Medicaid and Medicare payments;

- Adding lines to the Form 990 to inquire whether audited financial statements are made available to the public, and whether the audit includes an unqualified, qualified, adverse, or disclaimer of opinion; and
- Expanding mandatory electronic filing of the Form 990 to include more organizations.

Independent Sector and the broader charitable and philanthropic community have an extensive history working with the IRS and Congress to on specific issues related to the oversight and regulation of tax-exempt organizations. The charitable sector's deep commitment to ensuring this nation's laws and regulations are fair and effective while reflecting our priorities of accountability, transparency and good governance stems from an understanding that doing so enhances our effectiveness and ultimately improves our ability to better serve individuals, families, and communities.

Principles on Political Activity

Nonpartisan voter registration efforts, get-out-the vote campaigns, voter guides, and nonpartisan candidate forums are among the vital activities undertaken by both 501(c)(3) public charities and 501(c)(4) social welfare organizations to encourage civic participation and educate the general public.

These activities not only enhance the public's participation in our democracy, they are also one of the many ways these organizations advance their missions: helping the American public understand major issues facing our country in general and in particular during election cycles and encouraging them to register and cast their votes. Many communities also rely on the nonpartisan resources provided by tax-exempt organizations to assist in voter registration and increase voter turnout, understand the electoral process and the mechanics of voting, and inform the general public about policy issues and positions of candidates.

In 2012, only 59 percent of all eligible voters participated in the general election. A recent study by Nonprofit VOTE determined that nonpartisan voter engagement activities provided by nonprofit organizations increased participation across all registered voters, with the biggest impact on turnout among least-likely voters.⁷

These longstanding and widely accepted nonpartisan activities that encourage civic participation, strengthen our democracy and promote the common good and general welfare of our nation are often confused with partisan political activities aimed at influencing the outcome of elections. This confusion stems in large part because the definition and rules governing partisan political activity, which is permissible for certain tax-exempt organizations, are unclear.

The law states that 501(c)(4) organizations must be "operated exclusively to promote social welfare." Meanwhile, IRS regulations stipulate that political activities are permitted, so long as that is not the organization's "primary purpose." This has generally been interpreted by the courts and the IRS to mean that political campaign spending cannot exceed 49 percent of a social welfare

⁷ "Can Nonprofits Increase Voting among their Clients, Constituents, and Staff: An evaluation of the track the vote program." Nonprofit Vote. 2013. <http://www.nonprofitvote.org/documents/2013/08/can-nonprofits-increase-votingexecutive-summary.pdf>

organization's total spending.⁸ That vague limit, coupled with the absence of clear and consistent definitions of electoral campaign activity, has left the door open for the use of 501(c)(4) organizations for primarily political, rather than social welfare, purposes. The result has been confusion by the public on the role that the charitable community plays in the political arena.

These vague definitions and lack of clarity have had other consequences. Indeed, recent years have seen a significant infusion of money into political campaigns by 501(c)(4) organizations, with an investigation by the Center for Responsive Politics and the Center for Public Integrity finding that 501(c)(4)s outspent Super PACs by a 3-2 margin in the 2010 election.⁹ News reports on such electoral campaign spending by 501(c)(4) organizations tend to use the broad term "nonprofits," without distinguishing between 501(c)(4) social welfare organizations and 501(c)(3) public charities.

Independent Sector, concerned about the potential impact on the public confidence in the sector that may result from both the lack of clarity in the rules as well as increasing political activity by 501(c)(4) organizations, convened a group of nonprofit sector leaders, scholars, and legal experts to develop a set of principles on political activity by social welfare organizations.

The following set of principles was adopted by the Independent Sector board of directors in December, 2012:

1. Registration: 501(c)(4) organizations that intend to engage in electoral campaign activity should be required to formally file an exemption application with the IRS upon commencing operations.
2. Expenditure and activity limits: 501(c)(4) organizations should be permitted to engage in a modest amount of electoral campaign activity, defined by a clear percentage and/or dollar limit (similar to the 501(h) limits on lobbying by 501(c)(3) organizations) that is indexed for inflation.
3. Donor disclosure:
 - a. 501(c)(4) organizations that have a Board policy and organizational practice of not engaging in electoral campaign activity should not be subject to donor disclosure requirements.
 - b. 501(c)(4) organizations that engage in electoral campaign activity (i) should be required to disclose the identity and contribution amount of donors who give more than a specific annual contribution threshold, unless the donor prohibits the use of his/her donated funds for electoral campaign activity, and (ii) should be required to be transparent with donors, members, and the public about their work on electoral campaign activity.
 - c. If an organization has not notified a donor in writing at the time of solicitation that the funds may be used for electoral campaign activity and may subject the donor to disclosure, then it should be prohibited from using those funds for electoral

⁸ Richard Briffault, "Updating Disclosure for the New Era of Independent Spending" <http://ssrn.com/abstract=2040934> April 16, 2012

⁹ Center for Responsive Politics and Center for Public Integrity, <http://www.iwatchnews.org/2012/06/18/9147/nonprofits-outspent-super-pacs-2010-trend-may-continue>, June 2012

campaign activity unless written consent is obtained from the donor to use the funds for that purpose and to disclose the donor's identity as required by law or regulation.

- d. Organizations should not be subject to donor disclosure requirements if a federal regulatory body determines that the organization's exempt purpose involves issues for which donor disclosure would create a substantial likelihood of personal harm to donors.
4. Reporting of expenditures: 501(c)(4) organizations should be required to report to the IRS on a quarterly basis (and more frequently during federal election years) expenditures on electoral campaign activity, in addition to the quarterly FEC reports they are already required to file when engaging in express advocacy or electioneering communications, and should be required to make this information publicly available on their website in a timely manner.
5. Disclosure and reporting threshold: 501(c)(4) organizations that engage in a very minimal amount of electoral campaign activity should be exempt from donor disclosure and expenditure reporting requirements.
6. Applicability of gift tax: Consistent with the rules that apply to both 501(c)(3) charitable organizations and 527 political organizations, no gift tax should be imposed on donors who make contributions to 501(c)(4) social welfare organizations.
7. Accountability mechanisms (penalties): A 501(c)(4) organization that exceeds its expenditure limit, as well as organization leaders that violate the law knowingly or with reason to know, should be subject to penalties commensurate with the violation in order to deter future violations and the subversion of regulations. The IRS and FEC should promulgate rules in a timely fashion, and be appropriately staffed and funded to ensure expeditious and transparent enforcement.

Need for IRS Guidance

We applaud the IRS for recognizing the need for guidance to clarify federal rules governing political activity by tax-exempt organizations and transition beyond the ambiguous "facts and circumstances" approach to determine whether and to what extent an organization has engaged in political activity. It is precisely this lack of clarity, and the ambiguous facts and circumstances test which the IRS applies in making determinations about political activity that led to the improper handling of applications for exempt status by both conservative and liberal organizations.

A clear definition of candidate-related political activities and a clearly defined threshold for how much political activity is permissible will be a critical step toward providing regulators with a clear, unambiguous standard by which they review applications for tax-exempt status, and ensure transparency and consistent application of regulations for tax-exempt organizations. Following the 2013 revelations about the IRS mishandling of applications, we looked forward to the release of such guidance to provide much needed clarity for tax-exempt organizations to faithfully comply with regulations without fear of penalties and sanctions, while continuing to engage in the vital,

nonpartisan advocacy efforts that benefit and sustain the communities they serve and strengthen our democratic practices.

Unfortunately, the IRS's November 2013 proposed regulations failed to provide the necessary clarity for organizations engaging in candidate-related political activities and threatened to undermine the key role that charitable and social welfare organizations play in civic engagement work and public policy debates. Independent Sector voiced our specific concerns with the proposal, both in comments submitted to the IRS as well as in testimony before a House subcommittee.

Among our concerns with the initial IRS proposal was its overly broad definition of candidate-related political activities that conflated partisan and nonpartisan activities. Many communities rely on the nonpartisan resources provided by tax-exempt organizations to assist in voter registration and increasing turnout in elections, understand the electoral process and the mechanics of voting, and to inform the general public about policy issues and positions of candidates.

Particularly troubling about the initial IRS proposed guidance is that defining nonpartisan voter engagement activities as political for 501(c)(4) organizations may be interpreted by charities as having those limitations apply to them as well. Given the express prohibition for 501(c)(3) charitable organizations to engage in candidate-related political activity, risk-averse charities and their funders may be hesitant to engage in civic engagement activities defined as political in Section 501(c)(4) in order to avoid association with activities that the IRS views as political.

Federal guidance defining the scope of what it means to promote the common good versus engaging in political activity should recognize, if not support, the critical importance of nonpartisan voter engagement efforts that encourage the citizenry to fulfill their civic responsibilities. Our laws have long permitted tax-exempt organizations to encourage voter registration, urge eligible citizens to vote, and provide nonpartisan resources to assist the public in making informed judgments about candidates and their views. Our laws and regulations should facilitate more civic engagement, not less, and encourage the efforts of nonpartisan organizations working to achieve these outcomes.

The November 2013 proposal also failed to provide clarity around how much political activity is permissible. Without establishing a clear dollar or percentage limit for the amount of political activity in which 501(c)(4) social welfare organizations may engage, enforcement of the rules will remain subjective and require evaluations to be handled on a case-by-case basis. This will simply perpetuate the existing uncertainty on the part of organizations engaging in political activity. We believe that to maintain the integrity of social welfare organizations the percentage should be specific and modest.

Clarifying the rules will serve to increase compliance among those 501(c)(4) organizations attempting in good faith to comply with the laws and regulations, and reduce the opportunity for abuses by those who seek to circumvent them. Likewise, to prevent end-runs around rules designed to protect the integrity of 501(c)(4) social welfare organizations, the same parameters should be applied to 501(c)(5) labor unions, 501(c)(6) trade associations, and other tax classifications for which some political activity is permitted.

Recommendations

The 2013 proposed guidance for 501(c)(4) social welfare organizations on candidate-related political activities, while a welcome first step, should be substantially reworked to address the concerns outlined above.

Specifically, we urge the IRS in its upcoming proposed guidance to:

- Revise the definition of candidate-related political activities to avoid infringement on nonpartisan civic engagement work, voter registration activities, and candidate forums traditionally undertaken by tax-exempt organizations and avoid excessively restrictive blackout periods prior to elections that may undermine long-standing, nonpartisan issue advocacy;
- Create a universal definition of political activity across all 501(c) organizations in order to provide clarity and consistency for the consideration of tax-exempt status applications and to prevent the shifting of political activity to tax-exempt organizations not covered under the current proposed guidance; and
- Establish a clear limit of the amount of permissible political activity, defined either by a clear percentage or dollar amount. The permissible level should be insubstantial relative to an organization's size, and also indexed for inflation.

We also believe that IRS proposed guidance would be best served by moving away from the subjective facts and circumstances test in favor of a bright-line definition of political intervention that applies to all relevant 501(c) organizations, which the current guidance fails to provide. Independent Sector endorses the Bright Lines Project, whose recommendations include:

- Drawing a sharp, visible line to define the kind of speech in reference to a candidate that favors or disfavors their election;
- Creating safe harbors for genuine grassroots lobbying, fair comparisons of candidates that educate voters, and efforts to stimulate higher registration and turnout on election day;
- Applying stricter rules for paid mass media advertising and messages targeted to battleground districts and states;
- Adopting fair and sensible rules for the use and transfer of tax-exempt resources from one organization to another; and
- Cleaning up the ambiguities and inconsistencies that have given the IRS too much discretion under the present "facts and circumstances" approach.

These recommendations outline a uniform set of rules that would apply across all tax-exempt categories, provide predictability and clarity for what constitutes political activity, and protect free speech and encourage civic engagement while preventing many prevalent abuses of the system.

A multitude of factors contribute to the current ambiguity and uncertainty on the part of exempt organizations, the lack of enforcement of the existing rules governing political activity, and the increasing misuse of 501(c)(4) social welfare organizations for partisan political purposes. We urge the IRS to consider in totality these contributing factors, including existing donor disclosure and

registration and reporting requirements. In evaluating these issues, we further recommend that reforms reflect the Independent Sector principles on political activity outlined above.

We encourage the IRS to engage tax-exempt organizations in a meaningful dialogue to address the many concerns expressed during this comment process. For this reason, Treasury and the IRS should release a second draft of proposed political activity regulations as soon as possible. A new public comment period should be opened and public hearings should be held. This is absolutely necessary so the public may have the opportunity to provide input on a revised rule that better defines permissible political activity while preserving the important advocacy role and vital voice of tax-exempt organizations in civic engagement and public policy work.