



October 4, 2019

The Honorable John Lewis
Chair, Subcommittee on Oversight
Ways and Means Committee
United States House of Representatives
Washington, DC 20515

The Honorable Mike Kelly
Ranking Member, Subcommittee on Oversight
Ways and Means Committee
United States House of Representatives
Washington, DC 20515

RE: Subcommittee Hearing: How the Tax Code Subsidizes Hate

Dear Chairman Lewis and Ranking Member Kelly:

On behalf of the National Council of Nonprofits – the largest network of charitable nonprofits in the country – we are providing the views of charitable nonprofits on the topic of the Subcommittee’s September 19 hearing, “How the Tax Code Subsidizes Hate.” We abhor the violence described at the hearing and join with the Subcommittee members in denouncing the actions of any and all charitable nonprofits that played a role in inciting those evil acts. There is no acceptance of hate groups in the charitable community. There can never be acceptance of hate groups in America that conduct or incite violence.

The discussions during the September 19 hearing highlighted the important distinction between outrageous ideas, which are protected by the First Amendment, and illegal and harmful conduct, which is not. Drawing an accurate line between speech and conduct may be difficult, but other viable options exist for the Subcommittee to act in a constitutional way.

As discussed below, the National Council of Nonprofits and many other organizations committed to the wellbeing of the public and the work of charitable nonprofits – including state charity regulators, the Taxpayer Advocate, and even the IRS’s own Advisory Committee on Taxation – vociferously warned the Internal Revenue Service before and after it made a short-sighted management decision in 2014 that has enabled hate mongers and swindlers to hurt the public. More specifically, we and others sounded the alarm that the Service was abdicating its law enforcement duties and essentially inviting bad actors to operate as tax-exempt entities to line their own pockets and/or advance their own noncharitable agendas.

Sadly, our warnings proved accurate. As the Taxpayer Advocate has documented year after year, the Service has been approving an astoundingly high number of applications for tax-exempt status that do not comply with the law and are not eligible for consideration as 501(c)(3) organizations. The Service’s poor management decision has inadvertently opened the doors for bad actors to operate as tax-exempt entities and resulted in abuse of members of the public, the discrediting of legitimate nonprofits, injury to the country’s finances, and a rise in the challenges presented at the September 19 hearing.

IRS Form 1023-EZ: “Handing out charitable status like candy at Halloween”

In 2014, the IRS radically streamlined (or, some say, eviscerated) its application and approval process for certain organizations seeking tax-exempt status under Section 501(c)(3) of the Internal Revenue Code. It did so over the uniform objections of several entities intimately familiar with the

legal standards for tax-exempt status, the policy reasons behind those laws, and the practical implications to state and local law enforcement and tax collectors. It can be acknowledged that the IRS started with the good intention of seeking a common solution to two separate problems. The field had been calling for an alternative to the excessively long application form that may work for a new hospital or school with an expensive attorney on retainer but was unwieldy for citizens creating a small literacy group or local soup kitchen. Further, the agency was struggling to deal with a growing backlog of unprocessed applications due to a lack of staffing. The idea of creating a simpler form and easier process for smaller entities sounded reasonable in the abstract.

But, when the Service presented the contours of its initial plan to the professionals on its own [Advisory Committee on Taxation](#) in 2012, committee members rejected the concept of the Form 1023-EZ, warning of potential abuses. Specifically, the ACT stressed that the value of any increased simplicity “would be outweighed by the loss of educational value to the applying organization and the loss of effectiveness to the IRS.” The professionals made numerous alternative recommendations that the IRS largely ignored. Also, state charity regulators from across the country – law enforcement officials with a front-row seat to scams of the public by bad actors pretending to be charitable organizations – uniformly warned against the plan through the [National Association of State Charity Officials](#).

Despite the universal rejection of the proposal, the IRS proceeded in 2014 to implement its expedited approval process, essentially eliminating nearly every safeguard previously in place to protect the public. It approved use of a new application, the Form 1023-EZ, that, as its name suggests, is a much simpler form for securing tax-exempt status. The Form 1023-EZ is a three-page application that mostly asks applicants for contact information, intended charitable activities, and a list of board members. By using the new Form 1023-EZ, applicants are not required to submit evidence proving that they qualify for tax-exemption. For example, in a significant departure from the more-thorough review process, the form does not even require the person submitting the application to provide any proof that an entity even exists.

According to the Taxpayer Advocate ([Annual Report to Congress, FY 2017](#)), “the new procedures do not require applicants to submit their articles of incorporation or bylaws to ensure they are properly organized and have adopted the appropriate charitable purpose clause as well as protections against misuse of funds.” In short, just about any individual who fills out the short form, can get tax-exempt status as a 501(c)(3) charitable organization simply by claiming that they are who they say they are. A solo fraudster, a violent hate group, an innocent local Little League group – the Service now has no way of discerning which applicants legitimately qualify and which do not.

The IRS ignored warnings from its own [Advisory Committee on Taxation](#), the [National Association of State Charity Officials](#), the [National Council of Nonprofits](#), and others as it virtually eliminated its up-front screening of applications for charitable status. One [warning said](#), “Handing out charitable status like candy at Halloween is a bad idea.” Notably, the National Association of State Charity Officials [NASCO] sternly warned the IRS that “the Form 1023-EZ will increase opportunity for fraud and heighten the burden on state regulators.”

And that is what has happened. According to the [Taxpayer Advocate](#), IRS use of the Form 1023-EZ and the rubber-stamp approval process have resulted in the IRS erroneously awarding tax-exempt status at rates of 37 percent, 26 percent, and 42 percent during 2015, 2016, and 2017, respectively. The National Taxpayer Advocate's [Objectives Report to Congress for fiscal year 2019](#) underscored that the Form 1023-EZ “does not solicit enough information to allow the IRS to

determine, with sufficient accuracy, whether an organization qualifies for IRC § 501(c)(3) status and is therefore exempt from tax on its receipts.” The Taxpayer Advocate continued: “It is baffling that the IRS response does not acknowledge or address a 42 percent rate of noncompliance,” observing, “If taxpayers made such serious misrepresentations on their Form 1040 returns at a similar rate, we are certain the IRS would immediately take corrective measures.” Most damning is her conclusion: “The IRS’s ongoing refusal to address these concerns is nothing short of an abdication of its oversight responsibilities.”

These failings by the IRS now enable thousands of unqualified and perhaps unethical organizations to prey on the public, hurting those who give and diminishing trust in legitimate charitable nonprofits upon which so many people rely. We do not know how many hate groups have disguised their true purpose and secured tax-exempt status by way of the Form 1023-EZ. As recognized by all at the September 19 hearing, one would be too many. A more rigorous approval and evaluation process would almost certainly uncover groups dedicated to hate and illicit conduct, and thus deny access to taxpayer subsidies.

Therefore, we urge the Ways and Means Committee to pass legislation instructing the Internal Revenue Service to live up to its duty to enforce the law. In particular, the IRS must stop using its [truncated Form 1023-EZ](#) and its negligent screening process that have proven to be ineffective and defective. Legislation should further instruct the IRS to consult with charitable organizations, foundations, and state charity regulators to develop a streamlined form that continues to collect the information that is essential for the IRS to protect the public from bad actors and ensure that it grants tax-exempt status only to organizations that are eligible under the law.

Funding the IRS


As stated above, the agency started the simplification process with good intentions. But year after year, Congress reduced the funding the Service needs to do its important tasks, forcing IRS managers to try to do way too much with way too little. The results have been damaging to the agency and the country’s finances. [Treasury’s Inspector General](#) found that underfunding at the IRS caused the agency to curtail audits, which led to the government not collecting \$3 billion a year from one program alone. Congress cut the IRS budget by \$2 billion from 2010 to 2017, according to an investigation by [ProPublica and The Atlantic](#). The number of IRS auditors declined by a third over that time period, leading to a decline in audits of 42 percent. Due to the agency’s inability to follow up, \$8.3 billion in debts owed to the Treasury expired and became uncollectible just in 2017. The investigative article by [ProPublica and The Atlantic](#) observed: “The IRS’ ability to investigate criminals has atrophied as well.”

We share these data, and concerns, because the American people and charitable nonprofits alike depend on the Internal Revenue Service to be the cop on the beat enforcing the federal tax laws that govern all nonprofits. In November, we wrote to then-incoming Chairs Neal and Grassley to draw their attention to the serious need for tax committee oversight of the Internal Revenue Service. We stressed that the IRS needs resources and support of lawmakers in promoting transparency, ethical conduct, and close attention to the laws that protect nonprofits, taxpayers, and the public. Recognizing that those resources and support have not been forthcoming in recent years, we expressed fear that the charitable community has not received the protection from bad actors masquerading as legitimate charitable organizations that it needs to fulfill the many vital missions that serve the public good. The September 19 hearing confirmed, sadly, that those fears have become fact. (The entire November 26, 2018 letter is attached at the end of this letter.)

We – the public and nonprofits alike – depend on the IRS to enforce the law against fraud, lawfully screen applications for tax-exempt status, and provide help to the public and charities about appropriate stewardship of donor resources. The underfunding of the IRS by Congress has led to the result that the agency is no longer performing its most basic duties. Renewed funding, and vigilant oversight by Congress, are welcomed by the charitable nonprofit community.

In conclusion, we appreciate the statements of all the Subcommittee Members who expressed steadfast opposition to the exploitation of 501(c)(3) status for hateful purposes. We pledge to work with all who are committed to protecting the charitable community – and its vital work – from bad actors.

Sincerely,



Tim Delaney
President & CEO



David L. Thompson
Vice President of Public Policy

cc: Chairman Neal, Ranking Member Brady, and members of Subcommittee on Oversight

Attachment



November 26, 2018

The Honorable Charles Grassley
United States Senate
Washington, DC 20510

The Honorable Richard Neal
United States House of Representatives
Washington, DC 20515

Dear Senator Grassley and Representative Neal:

On behalf of the National Council of Nonprofits and our network of more than 25,000 organizational members, we write to congratulate you both for electing to become chairs of the tax-writing committees in Congress and assuming the lead in revising tax policies that work fairly for all Americans. In particular, we express deep appreciation for your public statements in support of working in a bipartisan manner in search of solutions to the many challenges our country faces. We pledge our eagerness to work with you to identify and implement responsible solutions and reforms.

Tax policy does far more than just define the nonprofit sector as tax exempt; whether intentionally or not, it also can promote fairness or its opposite, pick winners and losers, and support or ruin well-managed operations trying their best to improve the lives of others. We believe that the commencement of your chairmanships provides the perfect opportunity to design tax policies that intentionally promote stronger nonprofits and stronger communities. To that end, we offer the following recommendations for your consideration and action. These ideas reflect the perspective of the charitable nonprofit community, a major segment of the U.S. economy that employs more than 14 million taxpayers and interacts in many ways with the Department of Treasury and the Internal Revenue Service. The National Council of Nonprofits works with and through our members – the nation’s largest network of nonprofits – to identify emerging trends, share proven practices, and promote solutions that benefit charitable nonprofits and the hundreds of million people they serve in local communities throughout the country.

First, Do No Harm

The longstanding Johnson Amendment must be protected. For 64 years, it has successfully shielded charitable nonprofits, houses of worship, and foundations from the rancor of divisive partisanship and schemes by the unscrupulous to profit from tax deductions for disguised political campaign contributions. The Johnson Amendment accomplishes this by limiting tax-exempt status and the ability to receive tax-deductible charitable donations only to organizations that refrain from participating or intervening in any political campaign on behalf of or in opposition to any candidate for public office. The 501(c)(3) nonprofit community – frontline charities, churches, and foundations – stands strongly united in support of the federal law and in opposition to those attempting to politicize the charitable sector in their quest for partisan and financial gains. We ask that you pledge to stand with the broad 501(c)(3) community and state charity regulators by committing to preserving current law and rejecting all efforts to repeal or weaken this vital, and we believe existential, protection. You can learn more at www.GiveVoice.org.

Restoring Balance, Removing Impediments

Nearly 96 percent of America’s charitable nonprofits report annual budgets of less than \$5 million, and 92 percent bring in less than \$1 million per year. Many of these small- and mid-sized charitable organizations already have been struggling financially to advance their missions of improving lives, uplifting faith, and strengthening communities. So, it is quite troubling that the 2017 Tax Cuts and Jobs Act, which significantly reduced taxes for for-profit corporations and wealthier individuals,

attempts to defray some of the tax law's lost revenues by imposing new taxes on tax-exempt organizations. We ask that you lead efforts to correct these unjust outcomes that threaten to undermine the sustainability of community-based charitable organizations:

- **Unrelated Business *Income* Taxes on Nonprofit Transportation Benefits Expenses:** The new tax law, at Section 512(a)(7), imposes a 21 percent unrelated business *income* tax on nonprofits for expenses they incur for providing transportation fringe benefits to their employees, such as parking and transit passes. Reportedly, the justification offered for imposing a new income tax on nonprofit expenses was to ensure “parity” between for-profits and nonprofits regarding qualified transportation benefits. To most people, this rationale is flawed at its core. For-profit employers previously paid taxes on profits at a much higher tax rate and could deduct their expenses for providing transportation benefits to their employees. The tax deduction was an inducement for those employers to provide the employee benefit. The 2017 tax law dramatically lowered the taxes that for-profit businesses will now pay, if and when they have profits, and, as a minor reduction in the cost of the overall tax legislation, repealed the deductibility of the costs of the transportation benefits. Nonprofit employers, on the other hand, never had a deduction for these expenses and, importantly, never provided transportation benefits to gain a tax deduction. Rather, nonprofits have always provided transportation benefits to attract and retain workers, while helping to reduce traffic and air pollution. Nonprofits received little, if any, gains under the Tax Cuts and Jobs Act and yet are now subject to a new, illogical income tax on transportation benefits in the name of “parity.” We and many in the community consider the “parity” argument a false equivalency, and believe that repeal is appropriate. Please read the [National Council of Nonprofits’ comments](#) to Treasury and the IRS and [blog posting](#) for more information.
- **Unrelated Business Income Taxes on “Separate” “Trade or Business”:** New Section 512(a)(6) of the tax code directs nonprofits “with more than 1 unrelated trade or business” to somehow compute their unrelated business income (and related losses) earned “separately with respect to each such trade or business.” The law does not define what constitutes a “separate” trade or business, creating uncertainty about how nonprofits are supposed to document, compute, and report unrelated business income and losses. The tax change, which imposes unique liabilities on nonprofit organizations that are not assessed against for-profit businesses, went into effect on January 1, 2018, and has been subject to three separate quarterly estimated payments. Yet, the Treasury Department and IRS have yet to finalize the guidance needed to calculate those payments, and the guidance they have provided – calling on nonprofits to sort through hundreds of possible classification codes in the North American Industry Classification System – would inject further uncertainty, complexity, and expense into an already burdensome tax regime. The new tax is unfair and unjustified; it must be repealed. Please read the [National Council of Nonprofits’ comments](#) to Treasury and the IRS and [blog posting](#) for more information.
- **Paid Leave Tax Credit:** The 2017 tax law included new Section 45S, which provides a generous tax incentive for some employers to pay their employees who take family and medical leave. The incentive comes in the form of an income tax credit, something that nonprofit employers cannot utilize as tax-exempt entities. As a result, the tax law once again provides tax cuts and, with this provision, tax credits to for-profit employers, but extends no benefit to the nonprofit employers, which collectively employ more than 10 percent of the U.S. private workforce. This oversight in the law is easily remedied by permitting nonprofits to apply the credit to the payroll and other taxes they do pay. We urge you to include this common sense and fair solution in any tax legislation you advance in the future.

Every dollar taken from nonprofit entities as a tax is a dollar diverted from missions of serving individuals and communities. That’s why two other new taxes merit highlighting here, even though

they do not affect most charitable nonprofits. **Taxing compensation** above an arbitrary level undercuts the ability of charitable organizations to hire the most qualified talent to lead the significant work of nonprofits. The new **tax on the endowment returns** of certain institutions of higher education is unsound policy objectionable to all charitable organizations that have the foresight and ability to build reserves that are dedicated to advancing their missions. We ask that the tax committees resist the urge to invade the boardrooms of independent organizations and to refrain from overriding the fiduciary-based decisions of trustees with political judgments that do not take into account the challenges and solutions that these local experts deal with every day.

Strengthening Charitable Giving Incentives

Experts from across the political spectrum agree: the 2017 tax law significantly reduced tax incentives for Americans to give to the important work of charitable organizations across the country. While the law lowered tax rates and, in some cases, simplified future tax filings, there are undeniable adverse consequences. Early data already show declines in charitable giving, findings that likely will be fully documented when data are available in 2019 and beyond. That's why we and nonprofits across America call for immediate tax-law changes to provide stronger tax incentives that help taxpayers give back to good works in their communities. We briefly highlight three potential solutions, all of which are needed:

- **Enable all Americans to Claim Charitable Tax Deductions:** The doubling of the standard deduction means that 21 million fewer taxpayers will receive a tax benefit for giving back to their communities. While individuals give to the charities and missions they believe in, the evidence is clear that people give more because of the tax incentive. The removal of the incentive for 21 million taxpayers threatens to reduce giving by billions of dollars, meaning that giving will decline and community needs will not be met. We believe strongly that all taxpayers – and not just those who itemize – should have equal access to tax incentives to support their communities by donating to the work of charitable nonprofit organizations. Therefore, we urge your support for the creation of a **universal or non-itemizer charitable deduction** in the tax code.
- **Extend the IRA Charitable Rollover to Retirement Security Plans:** Another solution to the expected decline in charitable giving is a proposal to expand the IRA Charitable Rollover to allow seniors to make tax-free rollovers from their IRA accounts to charities through life-income plans (charitable gift annuities or charitable remainder trusts). In addition to providing resources for charitable works, the approach would promote greater retirement security for seniors to help ensure they do not outlive their resources. We believe that the [Legacy IRA Act](#) deserves serious consideration now or in the coming Congress.
- **Modernize the Volunteer Mileage Rate:** Volunteers who drive their vehicles in furtherance of a nonprofit's mission may claim only 14 cents per mile as a charitable itemized deduction, a rate that has been fixed in statute for decades. In contrast, paid employees, whether working for for-profit, nonprofit, or governmental entities, may receive up to 54.5 cents per mile as reimbursement without tax consequences. Even more unfair, volunteers who receive mileage reimbursements from nonprofits must pay income taxes on any amount greater than 14 cents per mile. Congress must update the substandard volunteer mileage rate and shield individuals from tax liability for reimbursement of their reasonable expenses when helping charitable nonprofits serve more people. Learn more about the [volunteer mileage rate](#).

Overseeing Tax Enforcement

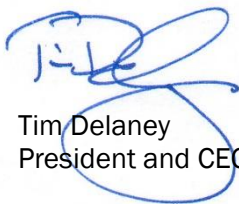
Finally, we call your attention to the serious need for your committees to conduct oversight of the Internal Revenue Service. As the primary cop on the nonprofit beat, the IRS needs resources and support of lawmakers in promoting transparency, ethical conduct, and close

attention to the laws that protect nonprofits, taxpayers, and the public. Sadly, those resources and support have not been forthcoming in recent years and, we fear, the charitable community has not received the protection from bad actors masquerading as legitimate charitable organizations that it needs to fulfill the many vital missions that serve the public good.

In our view, the most unfortunate outcome of this neglect of the IRS has been that agency's near abdication of its duties to protect the public by screening out unqualified or unscrupulous individuals who seek charitable tax-exempt status. In 2014, the IRS radically streamlined its application and approval process for certain organizations seeking tax-exempt status under Section 501(c)(3) of the Internal Revenue Code. In doing so, it ignored strong opposition and warnings expressed by its own expert Advisory Committee on Tax Exempt and Government Entities, the National Association of State Charity Officials (state regulators of nonprofit organizations), and the National Council of Nonprofits, among others. The IRS made the change for management reasons of reducing a large backlog of applications for tax-exempt status as 501(c)(3) charitable nonprofits. Due to the adoption of the **Form 1023-EZ**, the [Taxpayer Advocate](#) has found that virtually every entity that applies using the form receives tax-exempt status – thanks in part to erroneous approvals at rates of 37, 26, and 42 percent during 2015, 2016, and 2017, respectively. And the IRS' primary obligation of preventing ineligible organizations and perhaps bad actors from receiving and exploiting tax-exempt status for personal gain is being shirked with every application processed. IRS Form 1023-EZ should be withdrawn immediately. Learn more about the challenges of and the opposition to [IRS Form 1023-EZ](#).

We end with the offer made at the outset of this letter. The charitable community stands ready to work with you both to promote stronger nonprofits and stronger communities. The recommendations we make here would certainly fulfill those dual goals. We welcome the opportunity to explore these in greater detail and to work on additional solutions that benefit the common good.

Sincerely,



Tim Delaney
President and CEO



David L. Thompson
Vice President of Public Policy