

# Huge EO Scandals: Elusive Federal Oversight

03.10.20 | Linda J. Rosenthal, JD



In recent years, there's been an almost perfect storm of conditions for people – famous, infamous, and otherwise – to commit wrongdoing through exempt organizations (EOs) but escape scrutiny or consequences.

As the details of each high-profile scandal are splashed across the headlines, we collectively wonder whether any agency or official will take action about what seem to be brazen violations of the laws and regulations.

Sadly, more often than not, nothing happens. The Internal Revenue Service – and particularly the division with jurisdiction over EOs – has been so weakened by draconian budget cuts that effective federal oversight has almost disappeared. State attorneys general are valiantly acting to pick up the slack – with a success or two here and there – but they, too, face multiple obstacles.

According to anecdotal reports from professional advisors of EOs, there's an unfortunate trickle-down-effect from letting the well-known perpetrators "skate" on this repeated, in-your-face, wrongdoing. These lawyers and accountants report it's now difficult to get their clients to listen to them about "what they can and can't do." They "think we don't know what we're talking about when we tell them what the rules are." *EO Tax Journal 2020-1*, Paul Streckfus, Editor [paywall].

## *Gutting the Federal EO Budget*

The deliberate slashing of funds for the Internal Revenue Service in recent years is well documented. What's less widely known is that, in earlier periods as well, the IRS has been a favorite target of Congress. In conjunction with *The Atlantic*, nonprofit investigative agency Pro Publica capably explains this long history of intentional neglect in [\*How the IRS Was Gutted\*](#) (December 11, 2018).

Also taking up this narrative about the hollowing out of the IRS is Professor Philip Hackney of the University of Pittsburgh Law School. Formerly an attorney in the Office of the Chief Counsel (Treasury) in Washington, D.C., he argues in *The real IRS scandal has more to do with budget cuts than bias* (April 15, 2018) that this decimation of the tax agency has hit the Tax Exempt/Government Entities (TE/GE) Division particularly hard.

“Conservatives have been seething since 2013,” according to Professor Hackney, “over what they say was an unfair effort by the IRS to scrutinize right-leaning organizations more closely than other groups seeking nonprofit status.” That was the so-called “Lois Lerner scandal” which has since been entirely debunked by the Treasury Department’s inspector general for tax administration. There was no more preferential targeting of right-leaning groups than for left-wing applicants in the almost impossible task of figuring out which organizations qualify for section 501(c)(4) tax-exempt status under the fuzzy definition of “social welfare organization.”

As a first-hand witness of the informal comments Ms. Lerner made in May 2013 at a meeting of tax lawyers in Washington, D.C., Professor Hackney explains how he was was astonished at the bungled and misleading reporting of the event by the *Wall Street Journal*. The story was picked up by other media and partisan commentators who promptly labeled the IRS’s alleged actions “outrageous” and set off a firestorm.

### *EO Problems: Budget Not Bias*

In the years since then there have been congressional and FBI investigations of the Internal Revenue Service and its employees. There have also been lawsuits by conservative groups. Treasury officials, stung by allegations that “partisan bureaucrats” had improperly targeted right-leaning organizations, settled a lawsuit by the Tea Party in 2017. This capitulation included a multi-million dollar payment and an apology including one from then-Attorney General Jeff Sessions. Professor Hackney observes, though, that “... rather than proving that the IRS had picked on conservative groups, these inquiries detected managerial shortcomings” at the most. Agency failings, including the notorious long waits for tax-exemption application approvals, “... have more to do with budget cuts than bias.”

Nevertheless, and despite the express findings on this point in the Inspector General’s report, “Republicans proposed new laws to curb nonprofit regulation.” This “scandal” has caused deep and unnecessary damage to the cause of federal charity oversight already burdened by Congressional underfunding.

### *Form-EZ: More EO Oversight Troubles*

In mid-2014, there was another disastrous move by the Treasury and the Internal Revenue Service – caused in part by the massive budget cuts – that has only made the oversight problem worse. Federal officials introduced the heavily streamlined Form 1023-EZ. It was generally agreed that the Form 1023 tax-exemption application is too complex for small and mid-sized tax-exemption applicants. There was also a huge backlog and long wait for exemption approvals. From the start, the nonprofit sector vigorously opposed the new Form 1023-EZ on the grounds it is so short and simple that it can’t be an effective up-front screening tool.

That's exactly what happened. We've been covering this slow-moving train wreck since 2014 beginning with [\*Is the New Form 1023EZ Too Easy? Part I – Introduction\*](#) (September 10, 2014). By the middle of 2018, leaders of the nonprofit sector urged Congress to scrap the Form 1023-EZ entirely. As Tim Delaney of the National Council of Nonprofits characterized the express-lane character of the Form 1023-EZ review, it has become almost easier to get exemption approval than a library card. See [\*Nonprofits to Congress: Ditch Form 1023-EZ\*](#) (May 17, 2018).

## *Conclusion*

"The overall IRS budget fell by about 18 percent in inflation-adjusted terms from 2010 to 2017, from \$14 billion to roughly \$11.5 billion." While Congress added some funds since then, this bump-up was largely made and earmarked by the Tax Cuts and Jobs Act of 2017 to help with implementation of this "highly complex new law."

The trend of gutting the IRS has otherwise continued and "eroded oversight" at the same time that the "number of aspiring nonprofits" has risen dramatically. There are more applicants but much less capacity to screen them up front or check them out at the back end by audit. And the data show that denials of tax exemption are now rare as are revocations of tax exemption.

We'll continue this discussion in succeeding posts including how this dwindling oversight capability has allowed noncompliant groups to engage in – and continue – their wrongdoing in plain sight.