GENERAL

Nonprofits and the College Admissions Scandal

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Few Americans would have guessed when they woke up on Tuesday, March 12, 2019, that the lead news story that day would be the FBI hauling Aunt Becky off in handcuffs. What next? Are we soon to learn that police have discovered a dead body in the backyard of the home once owned by Mr. Rogers?

Information on the biggest college admissions scam in history unfolded rapidly that day. For the philanthropy community, a particularly unsettling feature is that the ringleader set up a sham 501(c)(3) charity through which to receive the bribe money and to pay it out to the people facilitating the cheating and other fraudulent acts. To add insult to injury, the use of the phony charity added an extra element of "value" for the parent-participants. Their payments bought them not only the desired college admissions but a tax deduction to boot! (Of course, no such tax deduction is permitted under these circumstances.)

IRS in Hot Seat on Admissions Scandal

It took no time at all before armchair critics wondered why the Internal Revenue Service hadn't earlier discovered this fraudulent scheme. (Neither did the FBI uncover the criminal enterprise as a result of its own sleuthing. It had serendipitous help from a tipster who offered the information in exchange for a better plea deal in his securities-fraud case.)

Could – or should – the tax agency have suspected and probed the Worldwide Keys Foundation? Experts in the nonprofit field quickly posted some thoughts on this issue. A consensus quickly emerged that the IRS should not be reproached; the agency has been under relentless budgetary attack by Congress for most of this decade. It **no longer has the resources** – above all, personnel – to maintain a rigorous (or even minimally adequate) audit or oversight capacity.

Paul Streckfus, a former IRS attorney and editor of the EO Tax Journal, believes that much of any possible blame here is at Congress's doorstep **for intentionally** and repeatedly slashing the Internal Revenue Service's charity oversight capabilities.

The question remains: if the agency had been sufficiently funded and staffed, could it have sniffed out this fraudulent scheme? Were there easily discoverable irregularities? Were there warning signs that should have triggered a serious investigation?

Marcus Owens, a former head of the exempt organizations division, says: "It goes to show the need for a much more sophisticated and real audit program…. And even so, they **still would have trouble catching** them."

"Tax practitioners caution that even increased audit coverage by the IRS wouldn't have caught the case, as **it involves vast, outright fraud**."

In ***Could a More Robust IRS Have Nipped the Varsity Blues Scandal in the Bud?***, Notre Dame law professor Lloyd H. Mayer responds to his own question: "Maybe, although we will never know for sure" noting that "there were certainly enough yellow flags in the IRS filings [of the Foundation] to signal something was wrong." But, he adds, the IRS is so underfunded that it doesn't have the " **capacity to review** those filings carefully" or "to pursue those flags" in most cases – "which the organizers of this scheme seemed to have recognized."

The National Council of Nonprofits' Rick Cohen agrees. "It's gotten to the point where **only 'screaming red flags'** are sufficient to draw the attention of the IRS" because of the massive underfunding of the section of the IRS that regulates nonprofits.

Admissions Scandal Nonprofit's Yellow Flags

Professor Mayer's "yellow flags" for Worldwide Keys Foundation gleaned from publicly available information returns include, for example:

- Zero fundraising expenses, although it has public charity status, and reports eventual contributions of millions of dollars annually
- Dramatic jumps in revenue, year after year
- No paid employees or volunteers
- Payments of huge, steadily escalating amounts to a consultant (who turned out to be the head tennis coach at Georgetown University)
- Only three directors; none were "independent"; that is, "all had financial ties to the foundation or related entities"
- Disclosure of ties to a related for-profit
- Odd patterns of grants and incomplete (or yellow-flag-raising) details
- No charitable organization recipients of grants

Why Did They Use a Charity?

Some observers have wondered why the scheme ringleader used a charity at all in this criminal enterprise. Wouldn't the special rules and restrictions, and the government oversight of a 501(c)(3) public charity, be a reason *not* to go this route?

Professor Mayer posits three reasons:

- "Using a charity may have caused fewer questions to arise when people not involved in the scheme happened to see the checks or electronic transfers."
- It offered a charitable deduction to the parents, or the option (according to information from the FBI affidavit) to pay from family foundations, or a donor-advised fund.
- The "organizers and maybe some of the parents knew that the IRS is mostly asleep at the switch." The gutting of the IRS budget has been well documented in the news.

Roger Colinvaux, a nonprofit tax law professor at Catholic University of America, agrees with the third point. The (scam) Foundation "appeared to be operating as though **it had no fear of getting audited** or getting caught."

Conclusion

"Nonprofit tax practitioners and former IRS officials say the agency needs to have **more bite behind its bark** going forward: **a low rate of auditing nonprofits won't spur the necessary compliance with tax laws**."

This case highlights why precisely **why underfunding the tax agency** is so shortsighted and dangerous.