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IRS Response to 501(c)(4) Scandal: Initial Assessment and Plan of Action

On June 24, 2013, Acting Commissioner of the IRS Daniel Werfel released a report titled “[Charting a Path Forward at the IRS: Initial Assessment and Plan of Action](#),” or, for the sake of brevity, the “Werfel Report.” The Report responds to the Secretary of the Treasury’s request for a 30-day update on the IRS’s progress in addressing problems identified in the [May 2013 audit report issued by the U.S. Treasury Inspector General for Tax Administration \(TIGTA\)](#).

The Werfel Report opens with a “mea culpa” and closes with an optimistic vision for the IRS’s future (including a nod to some of the Service’s prior accomplishments). The bulk of the 53-page Report, however, responds to each of the nine recommendations laid out in the TIGTA audit, providing the status of the IRS’s attempt to comply with each, the actions taken to date, and an estimated completion date.

Section 1: “Accountability”

Section One of the Report confirms that, while no intentional wrongdoing was uncovered, the Service has no plans to let anyone off the hook, emphasizing the recent overhaul in leadership and describing the formation of an Accountability Review Board to “establish criteria that supervisors must consider in determining an appropriate penalty to impose for an act of employee misconduct.” The Board is expected to provide recommendations for disciplinary action over the next 60 days, and beyond, if necessary, for employees currently on leave or who may be identified later.

Section 2: “Fixing the Problems with the Review of Applications for Tax Exempt Status”

Section Two addresses the IRS’s ongoing attempts to make things right. The Report describes a series of immediate actions, including

- › suspension of the use of BOLO (“Be on the Lookout”) lists,
- › development of new guidance for staff, adding technical and programmatic experts,
- › providing an [expedited application review for 501\(c\)\(4\) applications that have been in the backlog for more than 120 days](#), and
- › creating an “Advocacy Application Review Committee,” and “engag[ing] with the Department of the Treasury regarding the need for greater clarity for certain terms that are relevant for 501(c)(4) tax exempt organizations, with a commitment for inclusion in the next [Treasury Priority Guidance Plan](#).”

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Nonprofit Law Matters looks at legal issues in the nonprofit and tax-exempt organizations world. Written by the attorneys and paralegals of Adler & Colvin, it provides updates and analysis regarding philanthropy, charity, and other exempt organization issues.

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Notably, the expedited review option for 501(c)(4) applications in the backlog appears to have followed the [2004 advice of the American Bar Association's Exempt Organizations Committee's Task Force on Section 501\(c\)\(4\) and Politics](#), a Task Force co-chaired at the time by Greg Colvin and Miriam Galston. To be expedited, applicants must sign a letter under penalty of perjury attesting that, among other things, "the organization has spent and anticipates that it will spend less than 40% of both the organization's total expenditures and its total time (measured by employee and volunteer hours) on direct or indirect participation or intervention in any political campaign on behalf of (or in opposition to) any candidate for public office...." In 2004, the Task Force had recommended a "bright line test" for 501(c)(4) social welfare organizations requiring that the organization's expenditures for political activities be no more than 40% of total program service expenditures during the year.

With what some might call extraordinary optimism, Section 2 of the Report states that

We expect these various improvements and mechanisms to result in a rapid elimination of the existing backlog of applications for tax exempt status, with an initial focus on the backlog of potential political applications for tax exemption under Internal Revenue Code Section 501(c)(4).

It remains to be seen whether exemption applications will begin to move through the system faster. In the meantime, the [IRS website](#) still informs that, as of July 15, 2013, the IRS is assigning for review applications for exemption received in April 2012.

Section 3: "Broad Review of IRS Operations and Challenges"

Section Three of the Report indicates that the IRS is reviewing all "business units" to determine whether similar problems are occurring. While the general answer appears to be "no," the IRS plans to create "structural enhancements to improve the systematic and timely flow of information;" to "raise taxpayer awareness of their rights and tools, such as the [Taxpayer Advocate Service](#);" and to "establish routine reporting on IRS operational risks with Congress and the IRS Oversight Board."

The Report concludes by summarizing IRS accomplishments over the last decade, including technology-enabled innovations, enhanced international compliance, and high investment returns, noting that "enforcement actions alone generate revenue of nearly \$52 billion per year over the last decade, yielding an average Return on Investment (ROI) of \$4.65 for every dollar invested in the IRS during that time."

Clarification Needed from Other Branches of Government

While the Werfel Report by no means attempts to evade culpability, there is an important thread that appears throughout: the IRS is an enforcement agency, not a policy maker. In the words of Mr. Werfel, "It is important to make clear that the IRS does not write the country's laws (the Constitution places that responsibility in the hands of Congress), nor is the IRS responsible for the development of tax policy (the Department of the Treasury maintains that responsibility on behalf of the Administration)."

Echoing a sentiment we have previously expressed on this blog ([5/31/13](#), [5/20/13](#), [4/12/13](#), [5/21/12](#), [9/14/11](#)) about the need for bright lines to define and limit tax-exempt political campaign activity, Mr. Werfel adds that "Both the taxpayer and the IRS would benefit greatly from clear definitions of these concepts. The lack of clarity did not cause the inappropriate screening and poor managerial oversight noted in the TIGTA report, nor does it excuse them. But we do believe that it played a role in the lengthy delays in at least some of the determinations associated with these cases."

