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# SHOULD THE IRS NEVER “TARGET” TAXPAYERS? AN EXAMINATION OF THE IRS TEA PARTY AFFAIR

Philip Hackney\*

## I. INTRODUCTION

In 2012 and 2013, many congressmen and Tea Party organizations accused the Internal Revenue Service (“Service”) of “targeting” the Tea Party and other conservative political organizations.<sup>1</sup> The Treasury Inspector General for Tax Administration (“IG”) issued a report in 2013 that lent some credence to this claim.<sup>2</sup> The IG report faulted the Service for its method of screening applications for exemption from income tax.<sup>3</sup> While the IG did not use the term target, it stated broadly that “[u]sing the names or policy positions of organizations is not an appropriate basis for [the Service to identify] applications for review by the team of

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<sup>1</sup> See generally TAXPROFBLOG, <http://taxprof.typepad.com/>, archived at <http://perma.cc/PPR3-AL5L> (providing editor Paul Caron’s best collection of all the stories regarding this Tea Party matter). For instance, see Paul Caron, *House Demands IRS Documents on Alleging Harassment of Tea Party Groups*, TAXPROFBLOG (Apr. 12, 2012), [http://taxprof.typepad.com/taxprof\\_blog/2012/04/house-demands-irs-.html](http://taxprof.typepad.com/taxprof_blog/2012/04/house-demands-irs-.html), archived at <http://perma.cc/QNC7-JTLU>, for the stories discussing congressmen and Tea Party groups alleging in 2012 that they were being targeted. See Paul Caron, *The IRS Scandal, Days 1-100*, TAXPROFBLOG (Oct. 1, 2014), [http://taxprof.typepad.com/taxprof\\_blog/2014/10/the-irs-scandal-days-1-100.html](http://taxprof.typepad.com/taxprof_blog/2014/10/the-irs-scandal-days-1-100.html), archived at <http://perma.cc/M8CG-JM3T>, for a collection of materials from 2013.

<sup>2</sup> Treas. Inspector Gen. for Tax Admin., *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review*, Ref. No. 2013-10-053, 7 (May 14, 2013) [hereinafter IG Report].

<sup>3</sup> *Id.* at 5.

specialists.”<sup>4</sup> This Article seeks to determine whether any legal theories or ethical claims support this IG criticism. It also seeks to determine if the Service acted inappropriately in this case. This review finds with respect to the first issue that the IG criticism was too sweeping. The Service may generally use names to screen applicants to achieve certain policy goals such as uniformity of the law or to focus on taxpayers that may be in violation of the Internal Revenue Code (“Code”). It should exercise its discretion with greater care though where the Code provision it is enforcing impinges on a fundamental constitutional right.<sup>5</sup> On the second issue, this Article concludes that the Service had policy interests of both uniformity and potential violations of the Code when it utilized names in the Tea Party cases. Its actions thus fell within the scope of its discretionary authority. However, best practices would call for greater care from the Service when it is enforcing provisions that impact fundamental Constitutional rights.

Little positive law exists to guide bureaucrats in exercising discretionary authority.<sup>6</sup> This Article therefore looks to a number of disparate sources of law and professional guidance to try to identify legal and ethical norms that might apply to Service employees when choosing organizations to scrutinize. The review demonstrates that courts and Congress provide the Service and agencies wide latitude in exercising its investigatory and enforcement functions. For instance, the Supreme Court set a high standard for establishing a claim for selective enforcement. It has stated “the conscious exercise of some selectivity in enforcement is not in itself a federal constitutional violation . . .,” there must be a showing that “the selection was deliberately based upon an unjustifiable standard such as race, religion, or other arbitrary classification.”<sup>7</sup> Congress provides significant bureaucratic discretion to the Service in its revenue collecting function through the Anti-injunction

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<sup>4</sup> *Id.* at 7; *see, e.g.*, Second Amended Complaint, *Linchpins of Liberty v. United States*, No. 13-777 (Oct. 23, 2014) (providing the complaint against federal officials for targeting conservative groups for review of tax exemption).

<sup>5</sup> *See Oyler v. Boles*, 368 U.S. 448, 456 (1962) (determining that selective enforcement is not unconstitutional); *see also* Cass R. Sunstein, *Administrative Law Goes to War*, 118 HARV. L. REV. 2663, 2664 (2005) (discussing how reviewing courts and the Executive Branch should carefully handle constitutionally sensitive interests).

<sup>6</sup> *See, e.g.*, KENNETH CULP DAVIS, *DISCRETIONARY JUSTICE: A PRELIMINARY INQUIRY* 3 (1969) (stating that the author’s main focus is on how “to minimize injustice from exercise of discretionary power”); Martin Shapiro, *Administrative Discretion: The Next Stage*, 92 YALE L.J. 1487, 1487 (1983) (providing a discussion of the lack of control over administrative agencies’ autonomy).

<sup>7</sup> *Oyler*, 368 U.S. at 456.

Act and the Declaratory Judgment Act.<sup>8</sup> These judicial and legislative choices demonstrate a US democratic determination that greater justice is served by allowing the Service significant discretion in its choice in how to enforce the law within its jurisdiction.<sup>9</sup>

Although much has been written about the question of how to maximize tax enforcement with limited resources, there has been a tendency to ignore administrative law issues in the field of tax.<sup>10</sup> While tax scholars are now turning in earnest to consider the implications of administrative law on the administration of the Code, little has been written about any legal limitations on the Service's selection of persons and entities for examination generally.<sup>11</sup> Even less scholarship addresses the limitations on managing the Service's exempt organizations applications process.<sup>12</sup> This Article tries to fill that gap.

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<sup>8</sup> Cf. Kristin Hickman, *Administering the Tax System We Have*, 63 DUKE L.J. 1717, 1760 (2014) (suggesting that because the Service is often not collecting revenue, Congress should revisit its vast grant of injunctive protection to the Service).

<sup>9</sup> See *infra* Part III (discussing how the Court has shown a demonstrated commitment that an agency's choice not to enforce is generally beyond review of a court).

<sup>10</sup> See, e.g., Amandeep S. Grewal, *Foreword, Taking Administrative Law to Tax*, 63 DUKE L.J. 1625, 1625 (2014) (commenting that tax law was isolated from administrative law for decades). For a discussion of efforts to maximize tax enforcement with limited resources, see Leigh Osofsky, *Concentrated Enforcement*, 16 FLA. TAX REV. 325 (2014).

<sup>11</sup> See, e.g., Grewal, *supra* note 10, at 1625 (exploring how tax practice may be shaped by administrative law doctrines). But see Joseph J. Thorndike, *Reforming the Internal Revenue Service: A Comparative History*, 53 ADMIN. L. REV. 717, 718-19 (2001) (exploring the history of four efforts to reform the Service largely brought about because of frustration regarding a belief that the Service agents were abusively investigating taxpayers); Bryan T. Camp, *Theory and Practice in Tax Administration*, 29 VA. TAX REV. 227, 246, 259 (2009) [hereinafter *Theory and Practice in Tax Administration*] (considering the positive and negative impact of automated data processing on audits and also the importance of perceived procedural justice on taxpayer compliance); see also Lawrence Zelenak, *Should Courts Require the Internal Revenue Service to be Consistent?*, 40 TAX L. REV. 411, 411-12 (1985) (examining the administrative duty of consistency); Steve R. Johnson, *An IRS Duty of Consistency: The Failure of Common Law Making and a Proposed Legislative Solution*, 77 TENN. L. REV. 563, 563-64 (2009) [hereinafter *An IRS Duty of Consistency*] (proposing an amendment to the Code as a solution to the consistency dilemma); Christopher M. Pietruszkiewicz, *Does the Internal Revenue Service Have a Duty to Treat Similarly Situated Taxpayers Similarly?*, 74 U. CINN. L. REV. 531, 532-35 (2005) (discussing the IRS' duty of consistency as applied in several court cases). Also, more recently, a number of scholars have begun to consider the Service's choice not to enforce in general. For instance, see Leigh Osofsky, *The Case for Categorical Nonenforcement*, 69 TAX L. REV. (forthcoming 2015).

<sup>12</sup> However, after the Tea Party matter, several authors have analyzed some factors that might have led to the problem. See Lily Kahng, *The IRS Tea Party Controversy and Administrative Discretion*, 99 CORN. L. REV. ONLINE 41, 41, 51 (2013) (considering various controls that could be improved upon by the Service in carrying out its administrative discretion in managing its EO determinations program); Donald B. Tobin, *The 2013 IRS Crisis: Where Do We Go from Here?*, TAX ANALYSTS 1120, 1120 (2014) (recommending clearer regulations defining the boundaries of political activities for social welfare organizations,

Kenneth C. Davis speaks of the “discretionary justice that is beyond the reach of both judicial review and trial-type hearings,” in his classic title *Discretionary Justice*.<sup>13</sup> By discretion, Professor Davis means a public officer’s “discretion whenever the effective limits on his power leave him free to make a choice among possible courses of action or inaction.”<sup>14</sup> Importantly, this space includes many acts of a public officer that are not specifically directed by positive law. The question of how an agency should fairly choose organizations to review with greater rigor typically lies in this discretionary space that is generally, although not completely, beyond the reach of judicial review. The scope of this discretion in the case of the Service in its investigatory stage is especially large given the inquisitorial nature of tax administration, where the regulatory agency is charged with identifying taxpayers who are subject to tax.<sup>15</sup>

To put this question into concrete context, consider a couple of hypotheticals. Assume that instead of looking at organizations to determine if they were engaged in too much political campaign activity, the Service was reviewing the applications of charities engaged in bilking the parents of disabled children. Assume further that the name of the charities identified were either “Acme Charity, Inc.” or “Acme Foundation, Inc.” Assume agents identified four of these charities with these two different names applying for exemption, and also on examination, noticed that the Service had accidentally granted two others exempt status. Under these circumstances, we should expect the Service would search its computer system to identify any other “Acme Charity, Inc.” or “Acme Foundation, Inc.” in its applications system. Doing anything less would probably be malpractice on the part of the Service. However, with this approach, the Service would be using names for screening purposes in the determinations process. Yet, this process would not be problematic at all, legally or ethically. Why should it be any different in the case of examining whether organizations that might be engaged in too much political campaign intervention?

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but arguing that the better solution is to pass broad based campaign finance disclosure laws removing the necessity of the Service to make decisions on political activities of exempt organizations); George K. Yin, *Saving the IRS*, 100 VA. L. REV. ONLINE 22, 23 (2014) (arguing that we should increase the transparency of the EO determinations function by requiring the public disclosure of more determinations-related documents such as the application of exempt organizations).

<sup>13</sup> DAVIS, *supra* note 6, at 4.

<sup>14</sup> *Id.*

<sup>15</sup> See Bryan T. Camp, *Tax Administration as Inquisitorial Process and the Partial Paradigm Shift in the IRS Restructuring and Reform Act of 1998*, 56 FLA. LAW REV. 1, 19-20 (2004) (describing tax administration as inquisitorial).

A slightly different hypo is important as well. In this one, assume again that the Service happens to notice ten applications from organizations all named New Charity, Inc. Assume further that these organizations are engaging in a relatively new activity, and that the Service is not certain how the tax-exempt law will impact this new activity. If the Service directed its agents to send all of these applications to one agent or one group of agents to make certain the applications are worked in a uniform manner, we would think this a good use of limited resources as well. Yet again, the pulling of the applications would be based on name alone. Agents would screen for any New Charity, Inc. application without any indication that there might be a violation of the Code. This is also closely akin to the Tea Party cases, and yet fully unobjectionable. These two hypotheticals work to show that there is a common sense notion that the Service should be able to use names in screening applications for exemption.

That leaves us with the second question—was the IG correct to criticize the Service for utilizing names to screen in this particular case? There is no law that tells the Service how it must review applications from organizations seeking to be recognized as exempt from income tax. The Service followed its own procedures that apply to its operation of its application system.<sup>16</sup> Thus, there is no sub-constitutional law that demonstrates the Service violated the law by screening applications when it utilized the Tea Party-related names. Furthermore, the predominant way to establish a legal violation in this instance would be to establish that the Service violated equal protection principles by engaging in selective enforcement. But generally, that is only shown where the Service both selected and enforced the law that impacted a constitutional right against one group and not against others. The evidence suggests that the Service selected and enforced the law against many other groups.<sup>17</sup> Thus, the IG cannot point to a particular legal violation by the Service. However, from an ethical standpoint, the bureaucrats of the agency have a higher standard of care when utilizing screening techniques when the law enforced implicates a constitutional right. Here, the Service bureaucrats did not act with adequate care in utilizing names in this case, which arguably involved the fundamental constitutional right to speak.

This Article recognizes that the IG fulfills a special role that is different than a role filled by courts in reviewing agency action or

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<sup>16</sup> See IG Report, *supra* note 2, at 5 (outlining the Service's procedures in making the determinations).

<sup>17</sup> See *id.* at 8 (providing a breakdown of the potential political cases, including organizations with Tea Party, 9/12, or Patriots in the name).

Congress in passing legislation. However, this Article concludes that the IG can do real harm to Service function when it fails to be more precise in its criticism.<sup>18</sup> The IG should have done more to identify the legal or ethical basis upon which it bases its criticism. That would have gone a long way to narrowing the basis of criticism in this case.

Part II of this Article details the Service determination and examination processes.<sup>19</sup> The determination process is the application system the Service was administering when it reviewed the Tea Party applications.<sup>20</sup> The examination process is the process of auditing taxpayers.<sup>21</sup> These are both relevant to the Tea Party story to understand the challenges the Service faces in administering and enforcing the Code. Part III describes the law under the Code applicable to social welfare organizations, the primary organization involved in the Tea Party matter.<sup>22</sup> It is important in the sense that it establishes the predicate that the Service had good reason to review applications by Tea Party organizations with greater scrutiny than other applications. Part IV reviews legal and ethical principles that should apply to the Service when it reviews applications for tax-exemption.<sup>23</sup> While this Article concludes that the use of names to screen applications is allowed, and necessary, and it finds that when the Service is enforcing a provision that impacts constitutional rights, the Service has a duty to act with a high degree of care.<sup>24</sup> Part V applies these principles to the Tea Party matter.<sup>25</sup> The analysis finds that the Service did not violate any legal rules, but should have acted with greater care in the use of screening techniques because the particular Code section involved implicated important constitutional rights to freedom of speech and association.<sup>26</sup> Finally, Part VI concludes that the Service did not engage in a legal violation, but

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<sup>18</sup> See *infra* Part V.B (providing recommendations to avoid a similar situation in the future).

<sup>19</sup> See *infra* Part II (detailing the Service's processes used to target conservative organizations).

<sup>20</sup> See *infra* Part II.A (explaining the determination process).

<sup>21</sup> See *infra* Part II.B (discussing the examination process).

<sup>22</sup> See *infra* Part III (providing a discussion of the legal requirements for social welfare organizations under the Code).

<sup>23</sup> See *infra* Part IV (reviewing legal and ethical principles as a possible legal basis for finding an issue with the determinations process).

<sup>24</sup> See *infra* Part V.B (recommending that the Service act with a higher standard of care when reviewing applications for exemption).

<sup>25</sup> See *infra* Part V (applying the analysis to the Tea Party situation).

<sup>26</sup> See *infra* Part V.B (arguing that a higher standard of care must be exercised by the Service when Constitutional rights are implicated).

rather mismanaged the application process and failed to meet an ethical standard.<sup>27</sup>

## II. SERVICE EXEMPT ORGANIZATION APPLICATION SYSTEM AND EXAMINATION FUNCTION

This Part first discusses the exempt organization application system the IG criticized and then considers the examination system. The exempt organizations division of the Service (“EO”) reviews applications from nonprofit organizations seeking to be recognized as exempt from income tax in a process called the determinations process (“EO determinations process”).<sup>28</sup> The Service receives a high volume of paper applications annually, more than the Service apparently has the capacity to handle.<sup>29</sup> The Taxpayer Advocate listed as one of the most serious problems in 2012 as the overextension of Service resources in the EO determinations process.<sup>30</sup> Thus, the Service must make administrative and enforcement choices in managing the EO determinations process given its scarce resources. Because the Service faces a very similar scarce resource challenge in its examinations process, this Part also reviews the related methods the Service has chosen to manage its examination process.

### A. Determinations Process

A determination in EO refers to the process of reviewing an application from a nonprofit organization.<sup>31</sup> These organizations file an application with the Service to be recognized as tax exempt under

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<sup>27</sup> See *infra* Part VI (concluding that the Service did not meet ethical standards when it targeted the Tea Party and other conservative political organizations).

<sup>28</sup> See generally 26 U.S.C. § 501(c) (describing the list of tax exempt organizations); 26 U.S.C. § 501(a) (creating a tax exemption for organizations recognized as exempt).

<sup>29</sup> The Service’s recent adoption of the new Form 1023EZ appears to be changing this problem. The Service has recently moved through a significant backlog of exemption applications. *Progress Update on Form 1023-EZ*, IRS (Mar. 11, 2015), <http://www.irs.gov/portal/site/irspup/menuitem.143f806b5568dcd501db6ba54251a0a0/?vgnextoid=44beb23f06ffb410VgnVCM1000003b4d0a0aRCRD>, archived at <http://perma.cc/VMC5-86LL>.

<sup>30</sup> See NATIONAL TAXPAYER ADVOCATE 2012 *Annual Report to Congress*, 196–97, available at <http://www.taxpayeradvocate.irs.gov/userfiles/file/Full-Report/Volume-1.pdf>, archived at <http://perma.cc/SRX7-UEHU> (discussing overextension of Service resources as a problem in 2012); Identification of EO Technical Cases, IRM 7.20.1.4 (Dec. 20, 2012), available at [http://www.irs.gov/irm/part7/irm\\_07-020-001.html](http://www.irs.gov/irm/part7/irm_07-020-001.html), archived at <http://perma.cc/WQE2-VXTL> (showing an overview of determination letters for exempt organizations).

<sup>31</sup> See, e.g., Overview, IRM 7.20.1.1 (Dec. 20, 2012), [http://www.irs.gov/irm/part7/irm\\_07-020-001.html](http://www.irs.gov/irm/part7/irm_07-020-001.html), archived at <http://perma.cc/WQE2-VXTL> (explaining determinations letters for exempt organizations).

section 501(a) because described in section 501(c) of the Code.<sup>32</sup> A determination is a private letter ruling issued by the Service to a taxpayer that is only applicable to that taxpayer.<sup>33</sup> No congressional statute or rule requires the Service to make these private rulings on an organization's exempt status, and no rule requires the Service to provide such rulings in the case of social welfare organizations. However, the Service has long accepted requests from taxpayers for a letter assuring the organization that the organization will be considered tax-exempt. Congress has effectively approved and adopted the application system of the Service with respect to charitable organizations that seek status under section 501(c)(3).<sup>34</sup>

### 1. Very Brief History of the Determinations Process

Dating back to the income tax of the Civil War, the Service has required nonprofit applicants to prove their charitable status to claim exempt status.<sup>35</sup> With the enactment of the 1913 Income Tax, the Service enacted regulations to require that nonprofit organizations prove entitlement to exempt status.<sup>36</sup> Under the initial system, an organization seeking exempt status had to provide evidence to employees of the Service, called local collectors, that the organization was entitled to exempt treatment.<sup>37</sup> Tax regulations issued under the 1917 and 1921 Tax Act allowed any nonprofit organization seeking to avoid paying corporate income tax to file an affidavit with the collector in the district that the organization was located, setting forth the facts upon which the organization based its request for an exemption.<sup>38</sup>

A collector had authority to make a determination on exemption unless the collector was in doubt.<sup>39</sup> Thus, in the early years, the exempt determination was made in local field offices of the Service. Collectors

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<sup>32</sup> 26 U.S.C. § 501(a) (2012).

<sup>33</sup> See Rev. Proc. 2014-1, 2014-1 I.R.B. 7 (Jan. 2, 2014), available at <http://www.irs.gov/pub/irs-irbs/irb14-01.pdf>, archived at <http://perma.cc/KKU9-64NL> (setting out the definition of a letter ruling).

<sup>34</sup> See 26 U.S.C. § 508(a) (requiring organizations seeking to be recognized as charitable organizations to file a Notice with the Secretary of the Treasury).

<sup>35</sup> See Internal Revenue Act of 1864, 13 Stat. 223, 279 (1866) (explaining an amendment exempted from tax "managers of any . . . charitable, benevolent, or religious association" upon proof to the local collector of taxation that the profits would be applied to the "relief of sick and wounded soldiers, or to some other charitable use").

<sup>36</sup> T.D. 2693, 1918-1, C.B. 293; T.D. 3587, 1924-1, C.B. 247, 1924 WL 59031.

<sup>37</sup> Act of June 30, 1864, ch. 173, section 111, 13 Stat. 279.

<sup>38</sup> See Treas. Reg. § 231, art. 511 (1922), available at [http://www.constitution.org/tax/us-ic/regs/Regs\\_45\\_revised\\_for\\_1918\\_act.pdf](http://www.constitution.org/tax/us-ic/regs/Regs_45_revised_for_1918_act.pdf), archived at <http://perma.cc/FV38-VGDW> (discussing proof of exemption).

<sup>39</sup> *Id.*

were instructed to keep a list of organizations exempted from the corporate income tax and to occasionally inquire into whether these organizations continued to qualify for exemption.<sup>40</sup>

The Service appears to have changed its affidavit system into a private letter ruling system in the 1940s.<sup>41</sup> To claim an exemption, a taxpayer had to request a private ruling from the Service.<sup>42</sup> Before 1954, all of these applications for private rulings were directed to the national office in Washington, DC instead of to local field employees like the original system.<sup>43</sup> While in that year, the Commissioner provided authority in Revenue Ruling 54-164 to the District Directors to issue exemption letters in the field, it was not until fifteen years later that the directors began to develop expertise in this area.<sup>44</sup>

The modern EO determinations system, described in more detail below, got its start in 1969 with the enactment of section 508 of the Code. That section requires charitable organizations to provide notice to the Service to be recognized as exempt from tax.<sup>45</sup> While there are a number of other exempt organizations, such as voluntary employee benefit associations and certain trusts that are specifically required to provide a notice to the Service to be recognized as exempt, most organizations need not provide such a notice.<sup>46</sup>

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<sup>40</sup> *Id.*

<sup>41</sup> See David Ginsburg et al., *Federal Oversight of Private Philanthropy*, THE COMM'N ON PRIVATE PHILANTHROPY AND PUB. NEEDS, RESEARCH PAPERS, VOL. 5, 2585 (1977), <https://archives.iupui.edu/handle/2450/812>, archived at <http://perma.cc/5AR-HEPV> (reviewing the history of exempt organizations); see also Rev. Proc. 59-31, 1959-2 C.B. 949 (discussing the Service's private letter ruling system); Mortimer M. Caplin, *Taxpayer Rulings Policy of the Internal Revenue Service: A Statement of Principles*, NYU 20TH INST. ON FED. TAX 1-6 (1962) (detailing the history of the Service's private letter ruling system from the enactment of the 1913 income tax to 1962).

<sup>42</sup> See Ginsburg et al., *supra* note 41, at 2583 (discussing the history of exempt organizations); see also Rev. Proc. 59-31, 1959-2 C.B. 949 (discussing the Service's private letter ruling system).

<sup>43</sup> See Ginsburg et al., *supra* note 41, at 2584 (discussing the history of exempt organizations).

<sup>44</sup> See Rev. Rul. 54-164, 1954-1 C.B. 88 (noting the Commissioner's thoughts); Ginsburg et al., *supra* note 41, at 2584 (discussing the number of years it took for directors to implement expertise training).

<sup>45</sup> See Tax Reform Act of 1960, Pub. L. No. 91-172, Title I, § 101(a), 83 Stat. 494 (1969) (analyzing the notice required that needs to be given to the IRS for charitable organizations).

<sup>46</sup> FRANCES R. HILL & DOUGLAS M. MANCINO, *TAXATION OF EXEMPT ORGANIZATIONS*, 32.03 (2012); I.R.S. Serv. Center Advice 200046038, at 4 (Sept. 27, 2000), <http://www.irs.gov/pub/irs-wd/0046038.pdf>, archived at <http://perma.cc/>; e.g., Overview, IRM 7.25.1.1 (Sept. 26, 2014), [http://www.irs.gov/irm/part7/irm\\_07-025-001.html](http://www.irs.gov/irm/part7/irm_07-025-001.html), archived at <http://perma.cc/XPR4-42AS>. The overview provides that:

Except for most organizations described in paragraphs (3), (9), or (17) of section 501(c), the Internal Revenue Code does not require

Practically, even before the change in statutory requirement to file, many charitable organizations filed notices with the Service in order to be listed in Treasury Publication 78.<sup>47</sup> This is a list kept by the Service that provides notice that it recognizes a particular organization as exempt from income tax.<sup>48</sup> A donor that contributes to an organization listed in Publication 78 can be assured that the Service will treat the contribution as a charitable contribution deductible under section 170.<sup>49</sup> There are many other benefits to a charitable organization that files an application with the Service to be recognized as exempt.<sup>50</sup> The benefits to a noncharitable organization, however, such as a social welfare organization, are lesser. The primary benefit is certainty of tax treatment and general greater ease of dealing with the Service.

## 2. Current Determinations Process

This Section describes the procedures the Service operates under to conduct the EO determinations process. This is a description of the determinations process as it existed immediately before the Service made changes as a result of the Tea Party affair. It discusses the procedural guidance to demonstrate the effort the Service has made to confine the procedural discretion of its agents. Notably, this Section demonstrates that rather than ignoring its procedures, the Service appears to have followed its procedures in utilizing names to screen applications in the Tea Party matter.

Part seven of the Internal Revenue Manual (“IRM”) publicly describes the Tax Exempt Government Entities (“TEGE”) internal

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organizations to apply for recognition of exemption. An organization qualifies for exemption if it meets the requirements of the Code. However, an organization is subject to tax until it establishes that it qualifies for exemption, and most organizations find that filing an application for recognition of exemption is the least burdensome way to establish that they qualify.

*Id.*

<sup>47</sup> See Cumulative List, IRM 25.7.6 (Oct. 31, 2014), [http://www.irs.gov/irm/part25/irm\\_25-007-006.html](http://www.irs.gov/irm/part25/irm_25-007-006.html), archived at <http://perma.cc/RC2E-QFUA> (providing specifications for organizations to be included in Publication 78, which lists organizations that may receive tax deductible contributions).

<sup>48</sup> See *Search for Charities*, I.R.S., available at <http://www.irs.gov/Charities-&-Non-Profits/Search-for-Charities>, archived at <http://perma.cc/57ZF-QPU9> (providing a search engine for a cumulative list of charitable organizations since Publication 78 is no longer published).

<sup>49</sup> *Id.*

<sup>50</sup> See, e.g., Bazil Facchina, Evan Showell, & Jan E. Stone, *Topics in Philanthropy: Privileges & Exemptions Enjoyed by Nonprofit Organizations: A Catalog and Some Thoughts on Nonprofit Policymaking* (1993) (cataloging benefits of nonprofit organizations qualified as exempt from federal income tax).

procedures for issuing certain rulings and agreements to employee plans and exempt organizations. Other useful documents in understanding the determinations process as it existed include Revenue Procedure 2012-9, Publication 557 Tax-Exempt Status for Your Nonprofit Organization, and the annual EO Work Plan.<sup>51</sup>

Any nonprofit organization that wants to be recognized by the Service as exempt from federal income tax under section 501(a) of the Code because described in section 501(c) of the Code may apply to the EO Determinations function headquartered in Cincinnati, Ohio.<sup>52</sup> The employees in Cincinnati are considered to be working in a field office rather than a national office.<sup>53</sup> As will be seen though, the national office provides oversight and guidance to that field office. Charitable organizations seeking recognition under section 501(c)(3) generally must file a Form 1023 to seek tax-exempt status.<sup>54</sup> Other nonprofit organizations, such as social welfare organizations under section 501(c)(4) and business leagues under section 501(c)(6), must file a Form 1024 for tax-exemption recognition.<sup>55</sup> There are now twenty-nine different types of rather complex organizations described in section

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<sup>51</sup> See Rev. Proc. 2012-9, 2012-2 I.R.B. (Jan. 9, 2012), [http://www.irs.gov/irb/2012-02\\_IRB/ar10.html](http://www.irs.gov/irb/2012-02_IRB/ar10.html), archived at <http://perma.cc/Q8PN-YTMV> (noting that it is a useful document); IRS, IRS EXEMPT ORGANIZATION FY 2012 ANNUAL REPORT & FY 2013 WORK PLAN 1, 15-24, available at [http://www.irs.gov/pub/irs-tege/FY2012\\_EO\\_AnnualRpt\\_2013\\_Work\\_Plan.pdf](http://www.irs.gov/pub/irs-tege/FY2012_EO_AnnualRpt_2013_Work_Plan.pdf), archived at <http://perma.cc/8REG-SM28> [hereinafter WORK PLAN] (reviewing the 2013 IRS Work Plan).

<sup>52</sup> See *Tax-Exempt Status for Your Organization*, I.R.S. PUB. 557, 4 (Oct. 2013), <http://www.irs.gov/pub/irs-pdf/p557.pdf>, archived at <http://perma.cc/4M5G-GJXE> (noting the section 501(c) application process). In general, organizations seeking a status other than 501(c)(3) need not actually apply to the service to be considered exempt from income tax. Thus, a social welfare organization such as many of the Tea Party applicants could choose not to file with the Service. However, there is some risk associated with that choice. The Service could come back later and assert penalties and interest for failure to file taxes for a number of years. See *Exempt Organizations - Help from the IRS*, I.R.S. (Sept. 2, 2014), <http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Help-from-the-IRS>, archived at <http://perma.cc/DM94-LB9V> (providing customer service information for exempt organizations at the Service office in Cincinnati, Ohio).

<sup>53</sup> See Rev. Proc. 2013-9, 2013-2 I.R.B. (Jan. 7, 2013), [http://www.irs.gov/irb/2013-02\\_IRB/ar07.html](http://www.irs.gov/irb/2013-02_IRB/ar07.html), archived at <http://perma.cc/SYT5-9GA7> (describing the Cincinnati office as a field office).

<sup>54</sup> See *Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, I.R.S., available at <http://www.irs.gov/pub/irs-pdf/f1023.pdf>, archived at <http://perma.cc/7934-6T72> (taking note of the checklist).

<sup>55</sup> See *Form 1024, Application for Recognition of Exemption Under Section 501(a)*, I.R.S., <http://www.irs.gov/pub/irs-pdf/f1024.pdf>, archived at <http://perma.cc/EUU8-3PBU> (providing the tax-exemption form for welfare organizations and business leagues).

501(c).<sup>56</sup> Organizations that are not explicitly included within section 501(c) may also apply for an EO determination.<sup>57</sup>

The Service receives 60,000 to 70,000 applications for recognition of exemption annually.<sup>58</sup> These are all in paper form; there is no electronic means for filing the form.<sup>59</sup> Form 1023 for charitable organizations consists of twelve pages and eight possible schedules.<sup>60</sup> The recently developed Form 1023EZ for small charitable organizations is much shorter.<sup>61</sup> Form 1024 consists of nineteen pages including schedules.<sup>62</sup> In addition to the forms, an organization must attach articles of incorporation, bylaws, and numerous other supporting documents, such as financial data, explanations of answers, and publications.<sup>63</sup> Thus, in some cases, a full application can be well over 100 pages.

In putting this application process into context, it is important to note that nonprofit organizations, including social welfare organizations, are often deeply interrelated to other nonprofit organizations by person or idea. For instance, there are over 2000 local units of the National Association for the Advancement of Colored People, many of which are organized as social welfare organizations.<sup>64</sup> Similarly, with respect to the Tea Party-related organizations, there appear to be hundreds of organizations that are registered with the national Tea Party

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<sup>56</sup> See 26 U.S.C. § 501(c) (2012) (listing the twenty-nine types of exempt organizations).

<sup>57</sup> See, e.g., § 521 (exempting farmers' cooperatives from tax); § 527 (exempting political organizations from tax).

<sup>58</sup> See WORK PLAN, *supra* note 51, at 14 (noting the number of applications received); see also *Questions and Answers on 501(c) Organizations* (May 15, 2013), <http://www.irs.gov/uac/Newsroom/Questions-and-Answers-on-501%28c%29-Organizations>, archived at <http://perma.cc/8DCT-WSWG> [hereinafter *Questions and Answers*] (noting the number of applications received).

<sup>59</sup> See WORK PLAN, *supra* note 51, at 24 (noting the current 1023 is only available in a paper format, but the Service is working to get the funds to allow the electronic completion of Form 1023).

<sup>60</sup> See *Form 1023*, *supra* note 54 (providing twelve pages of the actual form and eight possible schedules).

<sup>61</sup> *Form 1023-EZ, Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, IRS (Jan. 28, 2015), available at <http://www.irs.gov/uac/About-Form-1023EZ>, archived at <http://perma.cc/5TU2-RL8J>.

<sup>62</sup> See *Form 1024*, *supra* note 55 (including nineteen pages of information and schedules that must be completed on Form 1024).

<sup>63</sup> See *Form 1023*, *supra* note 54 (providing a checklist of documents and information to be included with Form 1023).

<sup>64</sup> See NAACP, <http://www.naacp.org/pages/find-your-local-unit/>, archived at <http://perma.cc/M6U-5CPP?type=imagen> (providing access to local units); see, e.g., NAACP, Pittsburgh Branch Form 990, <http://www.guidestar.org/organizations/25-6086867/naacp-pittsburgh-branch.aspx>, archived at <http://perma.cc/3R3N-23UA> (providing that the NAACP is a social welfare organization).

organization.<sup>65</sup> Many of these have filed individual applications for exemption relying on support of the national tea party organization.<sup>66</sup> Other times, such as in the case of some supporting organizations, there is some tax shelter promoter who has encouraged the creation of highly similar organizations.<sup>67</sup>

Based on 2012 data, there were about 875 employees of the approximately 90,000 Service employees working in the EO division.<sup>68</sup> Of those, 330 work in the Rulings and Agreements division, with about 200 of those in the Cincinnati EO determinations office.<sup>69</sup> This is the workforce for the Service to manage this application system. EO Rulings and Agreements has jurisdiction to issue determination letters and ruling statuses to tax exempt organizations under sections 501(a) and 521, as well as a few other matters.<sup>70</sup> Given the vast quantity of annual applications and the resources at the Service's disposal, although the Service reviews every application, only a smaller set of organizations receive a closer look.<sup>71</sup> The Service summarily approves some applications.<sup>72</sup>

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<sup>65</sup> See generally *Locate a Local Tea Party Group*, TEA PARTY COMMAND CTR. BLOGGER SPOT, <http://teapartyorg.ning.com/page/tea-party-groups>, archived at <http://perma.cc/8HBJ-FJ4U> (listing over 700 Tea Party affiliates by state).

<sup>66</sup> *Id.*

<sup>67</sup> See, e.g., Stephanie Strom, *I.R.S. Takes on Tax Abuse by Charity Support Groups*, N.Y. TIMES, at B1 (Feb. 14, 2011), available at <http://www.nytimes.com/2011/02/15/business/15charity.html>, archived at <http://perma.cc/3CJA-EXXF> ("Lois G. Lerner, director of the exempt organizations division of the I.R.S., said the organizations that had been examined in the continuing investigation [of supporting organizations] were largely those linked to promoters that had been identified by other I.R.S. divisions.").

<sup>68</sup> See WORK PLAN, *supra* note 51, at 65 (noting the number of employees). Interestingly, in 1977, when there were around 230,000 charitable organizations registered with the Service, around 1000 employees worked in the exempt organizations office (total of 71,000 service employees). The Service issued around 2000 total determination letters a year at that time. See also Ginsburg et al., *supra* note 41, at 2578, 2581, 2593 (examining the history of the number of employees).

<sup>69</sup> See Annual Information Returns, IRM 7.25.1.5 (Sept. 26, 2014), [http://www.irs.gov/irm/part7/irm\\_07-025-001.html](http://www.irs.gov/irm/part7/irm_07-025-001.html), archived at <http://perma.cc/5GWU-SEZR> (explaining that the EO Examinations office has jurisdiction to examine exempt organizations).

<sup>70</sup> See Overview, IRM 7.20.1.1 (Dec. 20, 2012), [http://www.irs.gov/irm/part7/irm\\_07-020-001.html](http://www.irs.gov/irm/part7/irm_07-020-001.html), archived at <http://perma.cc/WQE2-VXTL> (noting the jurisdiction of determination letters).

<sup>71</sup> See WORK PLAN, *supra* note 51, at 14 (discussing the screening system put in place to quickly process low risk applications).

<sup>72</sup> *Id.* The Service recently developed Form 1023EZ recognizing this fact. See *Form 1023-EZ, Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, I.R.S., <http://www.irs.gov/pub/irs-pdf/f1023ez.pdf>, archived at <http://perma.cc/82DX-KAJG> (presenting Form 1023-EZ). It allows small organizations that meet certain requirements to file a smaller form and generally receive status much

A review of the IRM logically suggests that an employee reviewing applications first enters data from the application into the Service computer system, called the Letter Information Network User System ("LINUS").<sup>73</sup> The information entered into LINUS is additionally uploaded into the EO Determination System ("EDS").<sup>74</sup> From the IRM, it is not entirely clear how much information from the applications is included in LINUS, but considering the resources of the Service in EO determinations it appears likely that only a limited amount of information is actually input into this computer system.<sup>75</sup> One would logically expect that the name of the organization, its address, and simple yes or no questions that populate the forms are transcribed. Information such as financial data and narrative descriptions may very well never be entered into the database. If true, this would mean that the ability to search this system is likely quite limited in its scope and usefulness. A name may well be the most useful data for searching purposes.

In its 2012 Annual Report, EO states that it uses "screening" agents to divide applications into four different categories to process them most efficiently.<sup>76</sup> It is not clear from EO descriptions whether the "screening" agents are reviewing the information in EDS or whether they are reviewing the actual application. One presumes that it is the actual application and could perhaps involve simultaneous data entry. The categories include: (1) substantially complete applications where the initial reviewer is able to say the application can be quickly approved without further review; (2) applications that are not substantially complete; (3) applications where minor additional information is needed; and (4) applications where further development is needed to determine whether the organization meets tax-exempt status.<sup>77</sup> The report states that 70% of 60,000 applications, or 42,000, fall into the first three categories and, as such, are closed within 120 days of receiving the

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quicker than most organizations. This recognizes that many of these small organizations were being summarily approved anyway.

<sup>73</sup> See Overview, IRM 7.22.2.1 (Jan. 1, 2003), [http://www.irs.gov/irm/part7/irm\\_07-022-002.html](http://www.irs.gov/irm/part7/irm_07-022-002.html), archived at <http://perma.cc/AS5V-J5CF> (reviewing the Service data entry procedures).

<sup>74</sup> See *id.* (providing the application process, generally including exhibits showing screen data captures).

<sup>75</sup> *Id.*

<sup>76</sup> See Determination Letter Processing Overview, IRM 7.20.2.1 (Aug. 24, 2012), [http://www.irs.gov/irm/part7/irm\\_07-020-002r.html](http://www.irs.gov/irm/part7/irm_07-020-002r.html), archived at <http://perma.cc/NLS4-HW4E> (observing that this function is done by Technical Screeners in the Cincinnati, Ohio office).

<sup>77</sup> See WORK PLAN, *supra* note 51, at 14 (examining the four categories).

application.<sup>78</sup> That leaves approximately 28,000 applications falling into the unassigned category awaiting the attention of another agent to provide further development.

If an application falls into this unassigned category, according to the Annual Report, the average wait time for EO to assign an agent to an application is five months.<sup>79</sup> However, the annual report of the Taxpayer Advocate indicates that in 2012 the time before assignment was nine months.<sup>80</sup> Additionally, in August 2013, the Service website stated that EO was assigning cases to agents that were received in April 2012.<sup>81</sup> The Service no longer provides this information. Its institution of Form 1023EZ, along with automatic approval of applications from organizations willing to make certain commitments, appears to have generally cleared this significant backlog.

The IRM directs Service agents on how to handle particular applications with some detail.<sup>82</sup> When an application describes an organization that does not squarely fit within known legal precedent or describes an issue of national significance, the case is to be transferred to EO Technical.<sup>83</sup> EO Technical is a group of approximately forty tax law specialists in Washington, D.C. that is a part of the EO Rulings and Agreements division.<sup>84</sup> The IRM also lists twenty-one types of organization applications that must be transferred to these forty tax law specialists in EO Technical.<sup>85</sup> Some of those include prepaid health plans, organizations that present issues of commercial type insurance, complex hospital and health care operations, credit unions, and insurance companies.<sup>86</sup> Some of the other types of issues that the EO Technical group has likely had to deal with over the past five years

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<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

<sup>80</sup> See IRS, *2012 Annual Report to Congress*, TAXPAYER ADVOCATE SERVICE 196 (2012), <http://www.taxpayeradvocate.irs.gov/userfiles/file/Full-Report/Volume-1.pdf>, archived at <http://perma.cc/FHA7-VA9S> (noting the months it takes to be assigned).

<sup>81</sup> *Stalled Applications for Section 501(c)(3) Status: Is it Time to Sue the IRS?*, CAPLIN & DRYSDALE ATTORNEYS (Aug. 16, 2013), <http://www.capdale.com/stalled-applications-for-section-501c3-status-is-it-time-to-sue-the-irs>, archived at <http://perma.cc/YQ93-R47S>.

<sup>82</sup> See Identification of EO Technical Cases, IRM 7.20.1.4 (Dec. 20, 2012), [http://www.irs.gov/irm/part7/irm\\_07-020-001.html](http://www.irs.gov/irm/part7/irm_07-020-001.html), archived at <http://perma.cc/WQE2-VXTL> (describing how the EO technical cases are identified and processed by certain offices).

<sup>83</sup> See *id.* (describing the process of more complicated applications).

<sup>84</sup> See WORK PLAN, *supra* note 51, at 6 (noting the number of tax specialists).

<sup>85</sup> See Cases Reserved for EO Technical, IRM 7.20.1.4.1 (Dec. 20, 2012), [http://www.irs.gov/irm/part7/irm\\_07-020-001.html](http://www.irs.gov/irm/part7/irm_07-020-001.html), archived at <http://perma.cc/WQE2-VXTL> (noting the types of organization applications that are sent to the national office).

<sup>86</sup> See *id.* (noting the many types of organizations that must be transferred to the forty tax specialist in Washington, D.C.).

include the social welfare organization issue associated with the Tea Party cases, credit counseling, down payment assistance, supporting organizations, donor advised funds, hospitals because of new rules in the Affordable Care Act, Mortgage Foreclosure Assistance, and Regional Health Information Organizations.<sup>87</sup> Each of these types of cases either arose as a result of a change in the marketplace or a change in the law for exempt organizations. They all present highly technical, challenging calls for someone who practices law in the area of exempt organizations. Not only is the law challenging, but the organizational structure typically involves substantial complexity as well.

Also, long a part of the procedures in the Service has been a requirement that the field send certain challenging applications to the national office.<sup>88</sup> The IRM long-restricted field authority by providing that key district offices must also refer to Washington, D.C. all applications for exemption that involve "matters of extensive public interest, that is those in which the organization, its officers, or its activities are likely to generate."<sup>89</sup> Today, the IRM reflects a similar sentiment directing "[c]ases where issues are . . . not covered by clearly established precedent because they may have significant regional or national impact," to be sent to EO Technical.<sup>90</sup> Presumably, the Tea Party organizations fit under that description.<sup>91</sup> The IG speaks of a BOLO list used by the Service to ensure agents were identifying certain applications that should be sent to this EO Technical group.<sup>92</sup> It is likely that the BOLO list was a way of ensuring that the matters of "public interest" or national impact were properly sent to EO Technical to ensure individuals with a higher level of expertise paid attention to these applications.

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<sup>87</sup> *Id.*

<sup>88</sup> See Ginsburg et al., *supra* note 41, at 2592 (explaining that certain difficult applications are sent to the national office).

<sup>89</sup> See Cases Reserved for EO Technical, IRM 7.20.1.4 (Dec. 20, 2012), [http://www.irs.gov/irm/part7/irm\\_07-020-001.html](http://www.irs.gov/irm/part7/irm_07-020-001.html), archived at <http://perma.cc/WQE2-VX1L> (noting the types of organization applications that are sent to the national office). The Service recently changed the TEGE organizational structure such that the national office will no longer review these applications in the normal course of business. Rev. Proc. 2015-9, Section 5, IRB 2015-2 (Jan. 12, 2015). This recent revenue procedure does envision that determination letters are subject to some national review through EO Rulings and Agreements or the Office of the Chief Counsel. *Id.* at Section 9.

<sup>90</sup> *Id.*

<sup>91</sup> *Id.*

<sup>92</sup> See IG Report, *supra* note 2, at 6 (explaining that "the Determinations Unit began developing a spreadsheet that would become known as the 'Be On the Look Out' listing" and was abbreviated by the IG as a BOLO listing).

Once an application is properly assigned, an agent must make a determination. The agent can: (1) decide the organization did not properly apply and reject the application; (2) request more information from the organization; (3) deny the request for exemption subject to certain procedures; or (4) grant the request and issue an exemption letter.<sup>93</sup> The Service directs its employees to grant tax-exempt status only when an organization's status fits well within established law under the Code.<sup>94</sup> Courts hold that tax-exemption is a matter of legislative grace and is to be construed narrowly.<sup>95</sup> Very few applications, however, are in fact denied.<sup>96</sup>

### 3. Procedures for a Taxpayer to Challenge an EO Determination

If the Service is going to deny an application, it will first issue a proposed adverse determination. In that proposed denial, it will also inform the organization of its right to either appeal or protest that denial and request a conference to be heard.<sup>97</sup> An organization submits an

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<sup>93</sup> See Determination Letter Processing of Exempt Organizations, IRM 7.20.2 (Aug. 24, 2012), [http://www.irs.gov/irm/part7/irm\\_07-020-002r.html](http://www.irs.gov/irm/part7/irm_07-020-002r.html), archived at <http://perma.cc/NLS4-HW4E> (reviewing the denial and acceptance options); see also Rev. Proc. 2012-9, § 7, 2012-2 I.R.B. (Jan. 9, 2012), [http://www.irs.gov/irb/2012-02\\_IRB/ar10.html](http://www.irs.gov/irb/2012-02_IRB/ar10.html), archived at <http://perma.cc/DWT4-P3DG> (detailing the procedures available for an organization denied exempt status including the right to first receive a proposed denial and the right to protest that denial).

<sup>94</sup> See Cases Reserved for EO Technical, IRM 7.20.1.4.1 (Dec. 20, 2012), [http://www.irs.gov/irm/part7/irm\\_07-020-001.html](http://www.irs.gov/irm/part7/irm_07-020-001.html), archived at <http://perma.cc/WQE2-VX1L> (providing strict instructions for EO processing employees to follow when they process exempt organization applications).

<sup>95</sup> See, e.g., *IHC Health Plans, Inc. v. Comm'r*, 325 F.3d 1188, 1193-94 (10th Cir. 2003) (holding that tax exemption is a "matter of legislative grace" and therefore, it should be construed narrowly); *Mut. Aid Ass'n of Church of the Brethren v. United States*, 759 F.2d 792, 794 (10th Cir. 1985) (holding tax exemption is a "matter of legislative grace" and is construed narrowly); *Haswell v. United States*, 205 Ct. Cl. 421, 500 F.2d 1133, 1140 (1974), cert. denied, 419 U.S. 1107 (1975) ("Tax exemptions are matters of legislative grace and taxpayers have the burden of establishing their entitlement to exemptions.").

<sup>96</sup> See, e.g., Rob Reich, Lacy Dorn & Stefanie Sutton, *Anything Goes: Approval of Nonprofit Status by the IRS*, STANFORD CTR. ON PHILANTHROPY AND CIVIL SOC'Y 8 (Oct. 2009), <http://web.stanford.edu/group/reichresearch/cgi-bin/site/wp-content/uploads/2009/11/Anything-Goes-PACS-11-09.pdf>, archived at <http://perma.cc/8UMD-UD2M> (finding in a recent study that the Service has annually denied between 0.74% and 2.17% of applications for charitable status during the late 1990s to 2008).

<sup>97</sup> See Rev. Proc. 2013-9, § 7, 2013-2 I.R.B. (Jan. 7, 2013), [http://www.irs.gov/irb/2013-02\\_IRB/ar07.html](http://www.irs.gov/irb/2013-02_IRB/ar07.html), archived at <http://perma.cc/WDP8-HPPZ> (explaining the denial and appeal procedures); Rev. Proc. 2013-9, 2013-2 I.R.B. 262-63 (Jan. 7, 2013), available at <http://www.irs.gov/pub/irs-irbs/irb13-02.pdf>, archived at <http://perma.cc/S9XU-N9D3> (providing the procedure to follow when an exempt status is denied).

appeal made to the appeals division of the Service (“Appeals”).<sup>98</sup> Appeals has the authority to override the proposed adverse determination.<sup>99</sup> Additionally, if the organization submits a protest, the Service will review that protest and consider granting status.<sup>100</sup> Where the Service determines the organization does not qualify, it will then issue a final adverse determination.<sup>101</sup>

Congress limits the rights of taxpayers wishing to challenge actions of the Service. Congress has long maintained the Anti-injunction Act to prohibit a suit against the Service “for the purpose of restraining the assessment or collection of any tax.”<sup>102</sup> The primary avenue to challenge Service action is through refund jurisdiction.<sup>103</sup> A taxpayer must pay the tax to have access to a United States District Court or to the Federal Claims Court.<sup>104</sup> Congress provides a taxpayer an avenue to US Tax Court if the taxpayer files a claim within ninety days of receiving a notice of deficiency from the Service.<sup>105</sup>

The Supreme Court has interpreted the Anti-Injunction Act to be the expressed opinion of Congress that the Service should be provided significant discretion without judicial oversight to most expeditiously collect federal revenue.<sup>106</sup> Additionally, the Court recognizes a need to protect the Service from litigation before a suit for a refund.<sup>107</sup>

The Court held that the Anti-Injunction Act prohibits an action challenging a Service EO determination. In *Bob Jones University v. Simon*, the Court reviewed a revocation of charitable exempt status by the Service.<sup>108</sup> The Court held that as long as the Service appeared to be engaged in a good faith effort to enforce the law, there was no reason to upset the great deference that Congress grants to the Service in its revenue-enforcing activities.<sup>109</sup> Only upon a showing of both “irreparable injury” and that “it is clear that under no circumstances could the [g]overnment ultimately prevail” could a suit for injunction

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<sup>98</sup> See Rev. Proc. 2013-9, 2013-2 I.R.B. 262-63 (Jan. 7, 2013), available at <http://www.irs.gov/pub/irs-irbs/irb13-02.pdf>, archived at <http://perma.cc/S9XU-N9D3> (explaining the appeal process when an exempt status is denied by EO Determinations or EO Technical).

<sup>99</sup> *Id.* at 262.

<sup>100</sup> *Id.*

<sup>101</sup> *Id.* at 263.

<sup>102</sup> 26 U.S.C. § 7421 (2012).

<sup>103</sup> *Id.* § 7422(e).

<sup>104</sup> *Id.* § 7422(d).

<sup>105</sup> *Id.* § 6213(a).

<sup>106</sup> *Bob Jones Univ. v. Simon*, 416 U.S. 725, 736 (1974).

<sup>107</sup> *Id.*

<sup>108</sup> *Id.* at 726-27.

<sup>109</sup> *Id.* at 740.

proceed.<sup>110</sup> The Court acknowledged that the regime adopted by Congress was a harsh one.<sup>111</sup> “The degree of bureaucratic control that, practically speaking, has been placed in the Service over those in petitioner's position is susceptible of abuse, regardless of how conscientiously the Service may attempt to carry out its responsibilities.”<sup>112</sup> Nevertheless, the Court held that it did not have jurisdiction to review the suit.<sup>113</sup> The Taxpayer had a sufficient remedy though because it could pay a tax and challenge the determination through refund jurisdiction.<sup>114</sup>

Since that time, Congress enacted section 7428 to provide charitable organizations a judicial procedure to contest a denial or revocation of exempt status. Section 7428 provides that charitable organizations and certain cooperatives may challenge a denial or revocation of a determination in court.<sup>115</sup> Section 7428 also provides this right to these same organizations if the Service has not acted on an application within 270 days from the filing of the application if the organization has taken all timely steps to secure a determination.<sup>116</sup> Before the passage of section 7428, the only opportunity charitable organizations had to challenge a Service determination was to pay a small tax, such as the employment tax, and file for a refund on the basis that the organization did not owe the tax because it was exempt from tax as a charitable organization.<sup>117</sup> Congress has not provided this right to any other exempt organization, including social welfare organizations. These organizations still have access to court to contest a denial by paying a small tax and then claiming a refund on the basis that the organization is exempt from taxation.<sup>118</sup>

#### 4. Concluding Thoughts on the Determination System

There is little positive law to guide the Service's management of the determination process. In the case of the Tea Party organizations that

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<sup>110</sup> *Id.* at 737 (citing *Enochs v. Williams Packing & Navigation Co.*, 370 U.S. 1, 7 (1962)).

<sup>111</sup> *Id.* at 749.

<sup>112</sup> *Bob Jones Univ.*, 416 U.S. at 749–50.

<sup>113</sup> *Id.*

<sup>114</sup> *Id.* at 746.

<sup>115</sup> See 26 U.S.C. § 7428(a) (2012) (examining the statute for the right to judicially challenge a denial or revocation of a determination).

<sup>116</sup> *Id.* § 7428(b)(2).

<sup>117</sup> See *Bob Jones Univ.*, 416 U.S. at 727–28, 731 (1974) (holding that the Anti-Injunction Act prevented the university from seeking a declaratory judgment that the revocation of its exempt status as a charitable organization was improper without a showing of irreparable injury and lack of a reasonable interpretation of the Code).

<sup>118</sup> *Id.* at 746.

applied for social welfare status, there is no positive law requiring the Service to administer an application system at all. However, the Service employs extensive procedures to manage the exempt organization determination process, and it discusses how it manages that function on an annual basis. Furthermore, no Service procedure appears to prohibit the use of a name in its screening process. In fact, the evidence is that in high profile and other cases it has encouraged the use of names.

Part II.B briefly turns to the examination function.<sup>119</sup> The primary purpose of the Part is to describe the efforts the Service uses to identify taxpayer returns to review for audit.<sup>120</sup> While there has been little effort to consider the appropriateness of those particular processes from a justice standpoint, this Article operates from a presumption that these selection methods, so long used, are widely accepted as reasonable methods. Additionally, it traces the history of Service and Congressional recognition of how to best use the scarce resources of the Service.

### B. Examination Process

In the examinations process, the Service examines every return through an automated process, but picks organizations and individuals through a screening procedure to subject to the closer scrutiny of an audit. The Service uses a variety of means to select taxpayers for audit such as random statistical selection, known as the Discriminate Inventory Function System (“DIF score”), failure of certain Service information reporting to match up, and related party examinations.<sup>121</sup>

#### 1. Very Short History of Examination

The first US income tax, enacted in 1862, required the newly-created office of the Commissioner of Internal Revenue to use independent assistant assessors to collect and review every return of every person.<sup>122</sup> Quoting from a guide for assessors from the time, Professor Camp notes that “[e]ach assistant needed to ‘have continually before him an intimate

<sup>119</sup> See *infra* Part II.B (reviewing the Service’s examination process).

<sup>120</sup> See *infra* Part II.B (describing the efforts used by the Service to select taxpayer returns for audit).

<sup>121</sup> See, e.g., *IRS Audits*, I.R.S. (June 23, 2014), <http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/IRS-Audits>, archived at <http://perma.cc/P58N-XXPA> (providing a description of selection methods); *Tax-Exempt Status for Your Org.*, I.R.S. PUB. 557, 2 (2013), available at <http://www.irs.gov/pub/irs-pdf/p557.pdf>, archived at <http://perma.cc/4M5G-GJXE> (explaining the Service’s exempt organizations select check).

<sup>122</sup> ROY G. BLAKEY & GLADYS C. BLAKEY, *THE FED. INCOME TAX 527* (1940); see *Theory and Practice in Tax Administration*, *supra* note 11, at 229–34 (discussing the development of this process). This Part draws heavily from Bryan Camp’s work.

knowledge of his division, with its shops, factories, storehouses and stores . . . . Each assistant also needed to know ‘every person in his division who may be liable to license duty or income assessment.’”<sup>123</sup> There were 300 employees in Washington, D.C. and 3000 in the field to carry out this work.<sup>124</sup> Employees in the central office would review the work of the assessors in the field, but the system was controlled in the field by the personal assessments of the assistants.<sup>125</sup> Whether the Service was truly effective at accomplishing this personal collection goal is unclear.

The 1913 income tax quickly made clear that the Service could not realistically personally review every return. Evidence shows that as early as World War I the quantity of returns overwhelmed the abilities of the staff of the Service; the employees could not manage the onslaught.<sup>126</sup> The law still required mostly D.C.-centric assessors to review all returns and assess taxes by June 30.<sup>127</sup> However, all they were really able to do was to check for mathematical errors.<sup>128</sup> The Service estimated at the time that approximately 5% of the individual returns and 15% of the corporate returns should have been investigated more thoroughly.<sup>129</sup>

The workforce with this new income tax stayed relatively stable, but the number of returns increased exponentially. In 1915, the Service employed a workforce of 520 employees in Washington, D.C. and about 4200 outside of Washington.<sup>130</sup> These employees reviewed around 500,000 returns that year.<sup>131</sup> In 1917, taxpayers submitted more than 3.5 million returns.<sup>132</sup> The agency found itself with a backlog of returns such that by 1923 they were behind by 3 million returns.<sup>133</sup>

To manage this backlog, the Service tripled its workforce by 1919.<sup>134</sup> It also shifted some assessment work to assistant collectors in the field.<sup>135</sup>

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<sup>123</sup> *Theory and Practice in Tax Administration*, *supra* note 11, at 232 (quoting Treasury Circular 22, reprinted in CHARLES N. EMERSON, EMERSON’S INTERNAL REVENUE GUIDE 17 (Samuel Bowles & Co., Springfield, Mass., 1867)).

<sup>124</sup> *Id.* at 233.

<sup>125</sup> *See id.* (explaining the tax process).

<sup>126</sup> *See* BLAKEY & BLAKEY, *supra* note 122, at 528 (noting the difficulties the Service experienced with personally reviewing every return).

<sup>127</sup> *See* Tariff Act of 1913, Pub. L. No. 16, 38 Stat. 114, 169 (1915) (setting out the rules for assessments).

<sup>128</sup> *See* BLAKEY & BLAKEY, *supra* note 122, at 529 (addressing the clerks’ general lack of accounting and legal proficiency).

<sup>129</sup> *See id.* (discussing statistics reported by the Service).

<sup>130</sup> I.R.S., DEP’T OF THE TREAS., IRS HISTORICAL FACT BOOK: A CHRONOLOGY 89 (1993).

<sup>131</sup> *Id.*

<sup>132</sup> *Id.*

<sup>133</sup> *See* BLAKEY & BLAKEY, *supra* note 122, at 530 (explaining the dramatic increase in returns).

<sup>134</sup> *Theory and Practice in Tax Administration*, *supra* note 11, at 238.

Although at the time the idea of an audit lacked specificity, during this period the idea arose that some returns should be subject to more scrutiny than others, that is, some returns would be audited.<sup>136</sup> The Service processed and reviewed all returns to determine whether they should be accepted, but the Service did not audit all returns.<sup>137</sup> The 1918 changes to assessment procedure codified this idea of audit.<sup>138</sup> Before 1918, the law required the Service to make an assessment before any tax was due and owing, but after 1918 taxpayers had to pay the tax liability reflected on their returns when the returns were due.<sup>139</sup> The law now required the Service to assess the taxes "as soon as practicable."<sup>140</sup>

This distinction between audit and return processing became complete during World War II. During the war, the taxpaying population went from 7.6 million in 1939 to 42 million in 1945.<sup>141</sup> The Service increased its workforce from 22,000 employees to almost 50,000.<sup>142</sup> Professor Camp notes that whereas agents used to interact primarily with sophisticated taxpayers associated with businesses who kept good records, agents began to interact with the members of the public, who kept little in the way of records at all.<sup>143</sup> By the 1950s it was apparent that the Service could not review every return personally as had been initially established.<sup>144</sup> Professor Camp notes this time as the beginning of automatic data processing and the treatment of individuals not as individuals but as part of broad batches of taxpayers.<sup>145</sup>

The moral of the story is that the Service maintains a system where it can only enforce the law by picking and choosing a small sample of returns in the hopes of deterring other individuals from filing improper returns. This is typically referred to as the voluntary income tax system.<sup>146</sup> The accuracy and correctness of the system relies a great deal upon an expectation that taxpayers will follow the law. It backs that up by auditing a small number of taxpayers, and by sometimes prosecuting

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<sup>135</sup> See *id.* (discussing the increase in workers).

<sup>136</sup> See *id.* at 239 (addressing the changing goals surrounding tax returns).

<sup>137</sup> *Id.*

<sup>138</sup> See Revenue Act of 1918, Pub. L. No. 254, 40 Stat. 1057, 1082-83 (1919) (showing the requirement of a taxpayer to pay tax with a return).

<sup>139</sup> *Id.*

<sup>140</sup> Revenue Act of 1918, § 250, 40 Stat. at 1083.

<sup>141</sup> See *Theory and Practice in Tax Administration*, *supra* note 11, at 240 (discussing the significant change in the number of tax payers over six years).

<sup>142</sup> *Id.*

<sup>143</sup> *Id.*

<sup>144</sup> *Id.* at 241.

<sup>145</sup> *Id.* at 240-41.

<sup>146</sup> See Camp, *supra* note 15, at 5.

violators with criminal sanctions.<sup>147</sup> This means though that the Service must make decisions daily about whom to review more closely. As a result, the law will be enforced in a selective manner. Audit results in the Service treating similarly situated taxpayers differently. Part II.B.2 reviews the little that is known today about Service audit selection methods.<sup>148</sup>

## 2. Current Examination Selection

Today, there are a number of ways the Service might select a tax return for audit. On the Service Small Business Self-Employed webpage, the Service provides the three main ways it selects returns for audit: (1) computer screening using statistics (using a DIF score); (2) information reporting; and (3) related examinations.<sup>149</sup> Other factors may affect the Service's selection of returns for audit. For instance, other audit triggers include a return demonstrating a taxpayer with significant wealth, referrals, notoriety, or certain deductions that the Service finds are subject to abuse.<sup>150</sup>

### a. DIF

Developed in the 1950s when the Service began using the ADP process, a DIF score is based on a multi-factor computer process that allows the Service to determine that a particular return deviates too much from an expected range.<sup>151</sup> By placing returns into batches or identical classes reflecting income or other characteristics, the Service is able to use the computer to detect significant variations from the norm.<sup>152</sup> Agents pick returns with high DIF scores for a quick examination to

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<sup>147</sup> In fact, it is no secret that the Service specifically targets individuals of a high profile nature in its criminal enforcement to have the greatest enforcement effect in this endeavor. Joshua D. Blank, *In Defense of Individual Tax Privacy*, 61 EMORY L. J. 265, 293 (2011).

<sup>148</sup> See *infra* Part II.B.2 (reviewing the Service's audit selection methods).

<sup>149</sup> See *IRS Audits*, *supra* note 121 (explaining the three main methods the Service uses to select returns for audit).

<sup>150</sup> See DAVID M. RICHARDSON, JEROME BORISON & STEVE JOHNSON, *CIVIL TAX PROCEDURE* 97-98 (2d ed. 2008) (providing factors for consideration when the Service selects returns for audits).

<sup>151</sup> See *id.* at 95-96 (explaining DIF, which is a multi-factor computer process); see also Discriminant Index Function (DIF) Overview, IRM 4.1.3.2 (Aug. 10, 2012), available at [http://www.irs.gov/irm/part4/irm\\_04-001-003.html#d0e258](http://www.irs.gov/irm/part4/irm_04-001-003.html#d0e258), archived at <http://perma.cc/J5VW-5VH7> (setting out the types of DIF returns).

<sup>152</sup> See generally Discriminant Index Function (DIF) Overview, IRM 4.1.3.2 (Aug. 10, 2012), available at [http://www.irs.gov/irm/part4/irm\\_04-001-003.html#d0e258](http://www.irs.gov/irm/part4/irm_04-001-003.html#d0e258), archived at <http://perma.cc/J5VW-5VH7> (delineating the classes of DIF returns).

determine whether the return needs to go for a full audit.<sup>153</sup> The agents also determine the type of examination the exam should undergo.<sup>154</sup>

The formulae are secret and cannot be obtained via discovery or the Freedom of Information Act.<sup>155</sup> The Service initially operated a program that allowed significant precision in its DIF score system. However, the program, called the Taxpayer Compliance Measurement Program ("TCMP"), apparently subjected taxpayers to significant annoyance. For this reason, Congress forced the Service to shut the program down.<sup>156</sup> The Service ended the program in 1988, and some say that its shutdown has resulted in the DIF score being less reliable than it used to be.<sup>157</sup> The Service now runs a program called the National Research Program, started in the 2000s to replace the TCMP program.<sup>158</sup>

*b. Information Reporting*

The second audit trigger is based on information from conflicting information returns. The Service receives significant information from third-party payors.<sup>159</sup> This information allows the Service to confirm the accuracy of information reported by taxpayers on their returns.<sup>160</sup> For instance, employers file a W-2 form indicating how much income they paid an employee and how much tax they withheld; institutions like banks that pay interest must file a 1099-INT informing the Service how much interest a taxpayer received; corporations must file a 1099-DIV informing the Service how much in dividends a taxpayer received. All of this vast information is placed into a computer and matched against taxpayer returns to find discrepancies.<sup>161</sup> Where there is a discrepancy, a letter is triggered asking the taxpayer to explain the discrepancy.<sup>162</sup> A

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<sup>153</sup> *Id.*

<sup>154</sup> *Id.*

<sup>155</sup> See 26 U.S.C. § 6103(b)(2) (2012) (stipulating the confidentiality and disclosure of returns and return information).

<sup>156</sup> RICHARDSON ET AL., *supra* note 150, at 96; NAT'L RESEARCH PROGRAM, CHALLENGES ASSOCIATED WITH COLLECTING COMPLIANCE DATA 12 (June 12, 2002), available at <http://www.irs.gov/pub/irs-soi/cocompda.pdf>, archived at <http://perma.cc/NYS8-UGYC> (explaining that the Service stopped using the TCMP in 1988).

<sup>157</sup> RICHARDSON ET AL., *supra* note 150, at 96; NAT'L RESEARCH PROGRAM, *supra* note 156, at 10.

<sup>158</sup> RICHARDSON ET AL., *supra* note 150, at 96; NAT'L RESEARCH PROGRAM, *supra* note 156, at 1; see *National Research Program (NRP)*, I.R.S. (Aug. 18, 2012), <http://www.irs.gov/uac/National-Research-Program-%28NRP%29>, archived at <http://perma.cc/X643-A2MT> (discussing the Service NRP and its plan to update its DIF system).

<sup>159</sup> RICHARDSON ET AL., *supra* note 150, at 96.

<sup>160</sup> *Id.*

<sup>161</sup> *Id.*

<sup>162</sup> *Id.*

failure to explain, or a significant discrepancy, can result in an audit of the taxpayer.<sup>163</sup> The evidence is that any income subject to information reporting is reported at a highly accurate level.<sup>164</sup> Where there is no information reporting, income is not reported at a highly accurate level.<sup>165</sup>

*c. Related Examinations*

The third audit trigger is based on being a party related to a party that the Service is auditing. Some refer to this third type of selection as selection by infection.<sup>166</sup> On this matter, the Service states, “returns may be selected for audit when they involve issues or transactions with other taxpayers, such as business partners or investors, whose returns were selected for audit.”<sup>167</sup> Thus, the Service takes into account information it receives from one return to identify other parties it may need to review. Even if the Service has no specific information that one of these other parties has violated the Code, to be complete, the Service pulls in each of the important parties to the audit.<sup>168</sup> This could mean that if a closely held corporation’s return is examined, then the shareholders’ returns might be examined as well.

3. Final Thoughts on Examination Process as it Relates to the Determinations Process

The task set in this Article is to determine whether the IG had a proper legal or ethical basis for asserting that it was inappropriate for the Service to select an application for central review based on the applicant’s names. The Service has suggested that it utilized the names of the Tea Party in screening applications to centralize review and to ensure uniformity.<sup>169</sup> The history of the examination process illustrates that the Service regularly faces the problem of insufficient resources to manage its mandate.<sup>170</sup> Because the Service receives so many returns

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<sup>163</sup> *Id.* at 96–97.

<sup>164</sup> *Id.* at 97.

<sup>165</sup> RICHARDSON ET AL., *supra* note 150, at 97.

<sup>166</sup> *Id.* at 98.

<sup>167</sup> *IRS Audits, supra* note 121.

<sup>168</sup> See *Examination of Returns, Appeal Rights, and Claims for Refund*, I.R.S. PUB. 556, 3 (Sept. 2013), available at <http://www.irs.gov/pub/irs-pdf/p556.pdf>, archived at <http://perma.cc/2WJL-VKQR> (“The information is evaluated for reliability and accuracy before it is used as the basis of an examination or investigation.”).

<sup>169</sup> *Questions and Answers, supra* note 58.

<sup>170</sup> See *infra* Part II.A (discussing the problems with the determinations process); see also GARY C. BRYNER, *BUREAUCRATIC DISCRETION* 1 (1987) (suggesting that most agencies appear

and does not have enough employees or resources to evaluate all returns, the Service must focus on only a small selected set of taxpayers. Additionally, while the Service picks returns in very structured ways based on numbers and reporting failures, some returns are picked because of names, for example in the case of related party audits.<sup>171</sup> In those cases, the Service has identified an issue first, but then picks whom to audit based in part on the name.<sup>172</sup> Arguably, the organizations with the Tea Party name were all related parties, and, as will be developed in Part II.C, the Service had reason to believe these organizations might not qualify for the status they were seeking.<sup>173</sup>

### C. *What Happened in the Case of the Tea Party Organizations?*

To summarize the enormous amount of detail now available regarding the Tea Party matter, the Service explains that it began to see an uptick in applications for status as social welfare organizations in the years 2010 and 2011.<sup>174</sup> The increase seemed to be associated with organizations engaged in political activities.<sup>175</sup> The Service referred to this set of politically engaged social welfare organization applications as “Tea Party” cases.<sup>176</sup> The Service suggested that the uptick occurred as a result of the Court’s *Citizens United* opinion.<sup>177</sup> While all tax exempt organizations may engage in some politically related activities, in the case of social welfare organizations, the primary activity of the organization cannot be to intervene in a political campaign.<sup>178</sup>

To handle this increase of applications of social welfare organizations that appeared to be engaging in some level of campaign intervention, the Service decided to “centralize” the applications.<sup>179</sup> This meant that these applications were routed to agents who had experience

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to suffer from the problem of Congress providing a mandate too large for the resources provided).

<sup>171</sup> RICHARDSON ET AL., *supra* note 150, at 98.

<sup>172</sup> *Id.*

<sup>173</sup> See *infra* Part II.C (discussing the interrelation of hundreds of organizations registered with the Tea Party).

<sup>174</sup> *Questions and Answers*, *supra* note 58.

<sup>175</sup> *Id.*

<sup>176</sup> *Id.*

<sup>177</sup> See Paul Blumenthal, *IRS Tea Party Targeting Came After Court Rulings Upended Agency Role*, HUFF. POST (May 14, 2013), [http://www.huffingtonpost.com/2013/05/14/irs-tea-party-targeting\\_n\\_3272849.html](http://www.huffingtonpost.com/2013/05/14/irs-tea-party-targeting_n_3272849.html), archived at <http://perma.cc/6JJK-HTQQ> (discussing the large uptick in 501(c)(4) applications after *FEC v. Wisconsin Right to Life* and *Citizens United*).

<sup>178</sup> See Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) (“The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office.”).

<sup>179</sup> *Questions and Answers*, *supra* note 58.

in reviewing politically active social welfare organizations so that the cases would be “worked consistently.”<sup>180</sup> There is some discrepancy as to whether the initial decision was to focus on politically-engaged organizations or whether it was to focus on Tea Party-related organizations alone. Some testimony indicates that some Service employees viewed the term Tea Party cases as a generic category, like someone might refer to coke as a generic term for soft drink.<sup>181</sup> Other testimony seems to suggest that some employees understood in the early stage that they should be pulling and looking at only Tea Party-related organizations and should avoid looking at any others.<sup>182</sup>

Over a part of the period of the audit performed by TIGTA, review agents selected 298 organizations for screening of political activities.<sup>183</sup> The IG report identifies that ninety-six of these 298 cases included “tea party,” “Patriot,” or “9/12” groups—all ideologically conservative.<sup>184</sup> The allegiance of the other 202 organizations is not definitively known, although some appear to be liberal, some conservative, and some do not appear to have a political allegiance at all. The most troubling fact to TIGTA seemed to be that every organization with the “Tea Party” in the organization’s name ended up in this review group, but the same did not happen for every organization with the word “progressive” in its name.<sup>185</sup>

The IG also objected to the length of time these organizations were subjected to review and to the excessive questions that these organizations faced.<sup>186</sup> It is not clear whether the IG assessed how the

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<sup>180</sup> *Id.*

<sup>181</sup> Blumenthal, *supra* note 177.

<sup>182</sup> *Id.*

<sup>183</sup> *IG Report, supra* note 2, at 10.

<sup>184</sup> *Id.* at 8.

<sup>185</sup> In a letter from the IG to Representative Levin on June 26, 2013, the IG explained that at the request of Representative Levin, the IG performed an additional audit of the applications that the IG had reviewed. Letter from J. Russell George, Inspector General, to Sander M. Levin, Michigan Representative (June 26, 2013), available at [http://waysandmeans.house.gov/uploadedfiles/tigta\\_final\\_response\\_to\\_rep\\_levin\\_6.26.13.pdf](http://waysandmeans.house.gov/uploadedfiles/tigta_final_response_to_rep_levin_6.26.13.pdf), archived at <http://perma.cc/QS76-W8N9>. In that additional audit, the IG reviewed whether the Service had reviewed all organizations with the word “progress” or “progressive” in their titles. *Id.* The IG found that not all such organizations were subjected to greater scrutiny. *Id.* There was some confusion though about the use of the term “progressive.” Some news reports suggested that the IG found that the Service had not subjected “progressive” organization to enhanced review of political activities. Alan Framm, *J. Russell George, No Sign Progressives Were Mistreated by IRS*, HUFF. POST: POLITICS (Aug. 27, 2013), available at [http://www.huffingtonpost.com/2013/06/27/progressives-irs\\_n\\_3509983.html](http://www.huffingtonpost.com/2013/06/27/progressives-irs_n_3509983.html)?, archived at <http://perma.cc/T9EH-FEWE>. However, the only thing the IG said was that not every organization with the word “progressive” in its name was screened into the political activities basket. *Id.*

<sup>186</sup> *IG Report, supra* note 2, at 8.

questions provided to these organizations compared in intrusiveness, but the IG did determine that on average, organizations that got placed into this review group experienced a longer wait time in obtaining an exemption letter than the average organization applying for exemption.<sup>187</sup> Although the IG determined that the Service used inappropriate criteria, it found no evidence that the Service intentionally engaged in this activity.<sup>188</sup> Its evidence pointed more strongly to some management failures to run an effective operation that maintained proper controls over the determination system.

Importantly for the case made below, the IG found that the Service did not in fact operate with bias in its actions.<sup>189</sup> It identified no one that appeared to be carrying out a scheme to enforce the law more harshly against conservative organizations.<sup>190</sup> The Senate Permanent Subcommittee on Investigations found the same.<sup>191</sup>

### III. LEGAL REQUIREMENTS FOR SOCIAL WELFARE ORGANIZATIONS

This Part examines the rules that apply to social welfare organizations. The ambiguity of the social welfare legal regime is relevant to the consideration of the discretion the Service exercised in this Tea Party affair. It is a highly fact dependent inquiry. The ability to compare many of similar type organizations that present similar facts can aid the regulator in making consistent judgments regarding exemption.

Organizations described in section 501(c)(4) include civic leagues or organizations not organized for profit and operated exclusively for the promotion of social welfare.<sup>192</sup> Although Congress used the words “operated exclusively,” the Treasury regulations require social welfare organizations to be “*primarily* engaged in promoting in some way the common good and general welfare of the people of the community.”<sup>193</sup> That Treasury Regulations do not interpret the term “exclusively” literally, which is not inconsistent with Supreme Court precedent. In *Better Business Bureau*, the Court stated that exclusively “plainly means

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<sup>187</sup> *Id.* at 15.

<sup>188</sup> *Id.* at 5.

<sup>189</sup> *Id.* at 7.

<sup>190</sup> *Id.*

<sup>191</sup> UNITED STATES S. PERMANENT SUBCOMM. ON INVESTIGATIONS, IRS AND TIGTA MGMT FAILURES RELATED TO SECTION 501(C)(4) APPLICANTS ENGAGED IN POLITICAL ACTIVITY 1 (Sept. 5, 2014), *available at* file:///C:/Users/lawrev.LAWSCHOOL/Downloads/REPORT%20-%20IRS%20&%20TIGTA%20Mgmt%20Failures%20Related%20to%20501(c)(4)%20(Sept%205%202014,%209-9-14%20update).pdf.

<sup>192</sup> Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (as amended in 1990).

<sup>193</sup> *Id.* (emphasis added).

that the presence of a single non-educational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes.”<sup>194</sup>

The regulations state that a social welfare purpose includes working toward “bringing about civic betterments and social improvements.”<sup>195</sup> An organization is not considered to be exempt under section 501(c)(4) to the extent it provides benefits only to its members and not to the whole community.<sup>196</sup> The Service acknowledged the significant lack of clarity as to the meaning of a social welfare purpose in a continuing professional education text when it referred to this category as a “catch-all” for those beneficial organizations that it could not quite fit into the category of charitable.<sup>197</sup>

Some early courts tried to define the term civic organization. In *United States v. Pickwick Electric Membership Corp.*, the court stated that civic organizations involve “citizens of a community cooperating to promote the common good and general welfare of people of the community.”<sup>198</sup> Another court similarly defined civic organizations as a “movement of the citizenry or of the community.”<sup>199</sup> Although this is a different phrase than social welfare, the idea of a civic organization is also an aid to determining whether an organization qualifies under section 501(c)(4).

In 2009, about 9500 social welfare organizations reported holding almost \$100 billion in assets, receiving approximately \$85 billion in revenue, and incurring about \$82.5 billion in expenses.<sup>200</sup> Among the

<sup>194</sup> *Better Bus. Bureau of D.C. v. United States*, 326 U.S. 279, 283 (1945).

<sup>195</sup> *Treas. Reg. § 1.501(c)(4)-1(a)(2)(i)*; see also *Erie Endowment v. United States*, 316 F.2d 151, 156 (3d Cir. 1963) (holding that civic “organization[s] must be a community movement designed to accomplish community ends”).

<sup>196</sup> See, e.g., *Contracting Plumbers Coop. Restoration Corp. v. United States*, 488 F.2d 684, 687 (2d Cir. 1973) (finding membership organization of plumbers that repaired potholes of streets only its members had an obligation to repair not operated for a social welfare purpose because “each member of the cooperative enjoys these economic terms *precisely* to the extent he uses . . . [the] restoration services”); *Vision Serv. Plan, Inc. v. United States*, 265 Fed. App’x. 650, 651 (9th Cir. 2008) (finding vision services health maintenance organization not organized for social welfare because it “benefits VSP’s subscribers rather than the general welfare of the community”).

<sup>197</sup> *Social Welfare: What Does it Mean? How Much Private Benefit is Permissible? What is a Community?* I.R.S. EXEMPT ORG. CONTINUING PROF’L EDUC. TECHNICAL INSTRUCTION PROGRAM FOR 1981, Ch. G, at 39 (1981), available at <http://www.irs.gov/pub/irs-tege/eotopicg81.pdf>, archived at <http://perma.cc/S79X-QV3Q>.

<sup>198</sup> 158 F.2d 272, 276 (6th Cir. 1946).

<sup>199</sup> *Comm’r v. Lake Forest, Inc.*, 305 F.2d 814, 818 (4th Cir. 1962).

<sup>200</sup> *SOI Tax Stats – Charities & Other Tax-Exempt Orgs. Statistics*, I.R.S. (last updated Aug. 12, 2014), <http://www.irs.gov/uac/SOI-Tax-Stats-Charities-and-Other-Tax-Exempt-Organizations-Statistics>, archived at <http://perma.cc/96UQ-X56A>.SOI.

types of organizations that qualify as social welfare organizations are homeowners associations, health maintenance organizations, and many organizations that advocate for a particular cause.<sup>201</sup>

A contribution to a social welfare organization is not deductible under section 170 of the Code; however, payments to social welfare organizations may be deductible under another Code section.<sup>202</sup> For instance, a payment to a health maintenance organization for employee insurance may qualify for a medical expense deduction.<sup>203</sup>

Whatever social welfare or civic means, people and institutions have long used social welfare organizations as a vehicle to advocate partisan positions. For instance, in 1945 in *Debs Memorial Radio Fund v. Commissioner*, the United States Second Circuit Court of Appeals found that the operation of a radio station that was founded in 1928 to advocate “liberal or progressive” views established that the organization was operated for a social welfare purpose under the Code.<sup>204</sup> Today, many individuals and groups establish social welfare organizations to educate the public on partisan issues and to lobby to promote a particular cause.<sup>205</sup> In fact, charities often form social welfare organizations to conduct lobbying on their behalf.<sup>206</sup> The Court explicitly approved of such partisan positions being advocated by social welfare organizations on behalf of charitable organizations in *Regan v. Taxation with Representation*.<sup>207</sup> Finally, the Service has stated that a social welfare

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<sup>201</sup> See, e.g., 26 U.S.C. § 528(a) (2012) (qualifying many homeowner’s associations for income tax exemption).

<sup>202</sup> See, e.g., § 162(6)(C) (providing an exemption for employee health insurance).

<sup>203</sup> Such a payment would be deductible to the employer under § 162(6)(C) as an ordinary and necessary business expense, as well as excluded from the compensation of the employee under § 106(a) (2012).

<sup>204</sup> 148 F.2d 948, 951 (2d Cir. 1945).

<sup>205</sup> Lobbying has a very specific meaning for the Code and particularly for exempt organizations. It draws meaning from the limitation on charitable organizations to conduct no more than a substantial part of activity that constitutes the “carrying on of propaganda or otherwise attempting[] to influence legislation.” § 501(h) (2012). However, there is no need for a lengthy discussion of lobbying herein as the major issue associated with social welfare organizations is whether they are intervening in a political campaign.

<sup>206</sup> Planned Parenthood Federation of America, Inc., for instance, is a charitable organization under § 501(c)(3), but employs the Planned Parenthood Action Fund, Inc. as its major lobbying arm. See *About Us*, PLANNED PARENTHOOD (2015), <http://www.plannedparenthoodaction.org/about-us/>, archived at <http://perma.cc/PCT7-P272>; see also I.R.S. FORM 990, EIN 12-1644147 at 50, 77, 80-83 (2012), available at [http://www.plannedparenthood.org/files/2413/9620/1318/PPFA\\_FY13\\_Final\\_990\\_public\\_disclosure.pdf](http://www.plannedparenthood.org/files/2413/9620/1318/PPFA_FY13_Final_990_public_disclosure.pdf), archived at <http://perma.cc/E63M-XUQT>.

<sup>207</sup> 461 U.S. 540, 544 (1983).

organization may engage in lobbying as its sole activity as long as the activity is consistent with its exempt purpose.<sup>208</sup>

Although it is not entirely clear why there is a qualitative difference for purposes of qualifying for a social welfare purpose between lobbying and intervening in a political campaign, the latter is not considered a valid social welfare purpose. The Treasury regulations explicitly state that the “direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office” explicitly does not advance a social welfare purpose.<sup>209</sup> The Court implicitly accepted this idea in *Taxation with Representation* as well when it accepted that the exemption arrangement established in the Code allowed charitable activities to be conducted by charitable organizations, lobbying to be conducted by social welfare organizations, and campaign intervention through a PAC under section 527.<sup>210</sup> According to Service guidance, a social welfare organization may intervene in a political campaign as long as intervening in a political campaign is not the organization’s primary activity.<sup>211</sup>

However, knowing that a social welfare organization may not intervene in a campaign to promote social welfare tells us neither when an organization has intervened in a campaign nor when it has done too much intervening. These two legal questions were at the heart of the Tea Party matter. Until recently, our best understanding of what it meant to intervene in a campaign came from the definition of that term for charitable organizations.<sup>212</sup> In that guidance, the Service provided twenty-one situations applying a facts and circumstances test to

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<sup>208</sup> Rev. Rul. 61-177, 1961-2 C.B. 117, available at <http://www.irs.gov/pub/irs-tege/rr61-177.pdf> (last visited Apr. 12, 2015), archived at <http://perma.cc/9MYH-543G>; see also John Francis Reilly & Barbara A. Braig Allen, *Political Campaign and Lobbying Activities of IRC 501(c)(4), (c)(5) and (c)(6)*, EXEMPT ORGS.-TECHNICAL INSTRUCTION PROGRAM FOR FY 2003 L-2 (explaining the general rules about lobbying and political campaign activities by exempt organizations); Ellen P. Aprill, *Regulating the Political Speech of Noncharitable Exempt Orgs. After Citizens United*, 10 ELECTION L.J. 363, 375-91 (2011).

<sup>209</sup> Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) (as amended in 1990).

<sup>210</sup> *Tax'n with Representation*, 461 U.S. at 544.

<sup>211</sup> Rev. Rul. 81-95, 1981-1 C.B. 332 (last visited Apr. 12, 2015); Reilly & Allen, *supra* note 208; Aprill, *supra* note 208, at 381. An organization that engages primarily in intervening in political campaigns is instead described in section 527 of the Code assuming the organization follows the requirements of that section. Also, a tax is imposed on the lesser of investment income or an amount spent on political activity of any organization exempt under section 501(a) because section 501(c) describes when such an organization engages in political activity. 26 U.S.C. § 527(f) (2012). For more information on that relationship, see Rev. Rul. 2004-6, 2004-4 I.R.B. (Jan. 26, 2004), [http://www.irs.gov/irb/2004-04\\_IRB/ar10.html](http://www.irs.gov/irb/2004-04_IRB/ar10.html), archived at <http://perma.cc/A7Y6-CKZZ?type=image>.

<sup>212</sup> Rev. Rul. 2007-41, 2007-25 I.R.B. (June 18, 2007), available at <http://www.irs.gov/pub/irs-drop/rr-07-41.pdf>, archived at <http://perma.cc/W8UW-AWXN>.

determine whether an organization was advocating for or against a candidate for public office.<sup>213</sup> Despite utilizing twenty-one different situations as a result of the adoption of a facts and circumstances test, there is still much room for administrative discretion.<sup>214</sup> The Service recently proposed regulations to clarify this area of law for social welfare organizations.<sup>215</sup> However, after receiving over 150,000 comments, the Service decided to reconsider its proposed regulations.<sup>216</sup>

Determining whether an organization has intervened in a political campaign too much is no less ambiguous or contentious. The initial problem is that the statute requires a social welfare organization to operate exclusively for a social welfare purpose.<sup>217</sup> The regulation, however, interprets the term exclusively to mean primarily.<sup>218</sup> The inquiry tends to focus on whether the activity evinces a dominant or just an ancillary purpose of the organization based on all the facts and circumstances.<sup>219</sup> In *Contracting Plumbers*, a case focused on the exclusively standard of the statute, the court stated regarding the requirement that, "we adhere to the rule that the presence of a single substantial non-exempt purpose precludes exempt status regardless of the number or importance of the exempt purposes."<sup>220</sup> This standard leaves much room for administrative discretion.

Unlike charitable organizations, most of which are required to file a notice via the Form 1023 to be recognized as exempt by the Service, there is no such notice that social welfare organizations are required to file to

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<sup>213</sup> *Id.*

<sup>214</sup> *Id.*

<sup>215</sup> *Treasury, IRS Will Issue Proposed Guidance for Tax-Exempt Social Welfare Organizations*, I.R.S. (Nov. 26, 2013), <http://www.irs.gov/uac/Newsroom/Treasury,-IRS-Will-Issue-Proposed-Guidance-for-Tax-Exempt-Social-Welfare-Organizations>, archived at <http://perma.cc/F2S4-8F9F>.

<sup>216</sup> Reg-134417-13, 2013-52 I.R.B. (Dec. 23, 2013), [http://www.irs.gov/irb/2013-52\\_IRB/ar18.html](http://www.irs.gov/irb/2013-52_IRB/ar18.html), archived at <http://perma.cc/6EJW-32RV>.

<sup>217</sup> Martha B. Lackritz, *Comments on Proposed Regulations Show Exempt Organizations' Concerns*, ADLER & COLVIN (Oct. 2014), available at [http://www.adlercolvin.com/pdf/COMMENTS\\_ON\\_PROPOSED\\_REGULATIONS\\_SHOW\\_EXEMPT\\_ORGANIZATIONS\\_CONCERNS\\_Taxation\\_of\\_Exempts\\_WG\\_L\\_\\_Se.doc%20%20%2800632574xA3536%29.pdf](http://www.adlercolvin.com/pdf/COMMENTS_ON_PROPOSED_REGULATIONS_SHOW_EXEMPT_ORGANIZATIONS_CONCERNS_Taxation_of_Exempts_WG_L__Se.doc%20%20%2800632574xA3536%29.pdf), archived at <http://perma.cc/JZP6-KWPR>.

<sup>218</sup> Treas. Reg. § 1.501(c)(4)-1(a)(2) (2013).

<sup>219</sup> For a short discussion of the issue regarding primary and exclusively, see Philip T. Hackney, *A Response to Professor Leff's Tax Planning "Olive Branch" for Marijuana Dealers*, 99 IOWA L. REV. BULL. 25, 29 (2014).

<sup>220</sup> *Contracting Plumbers Coop. Restoration Corp. v. United States*, 488 F.2d 684, 686 (2d Cir. 1973).

be recognized as exempt organizations.<sup>221</sup> A social welfare organization must annually file a Form 990 Return of an Exempt Organization.<sup>222</sup>

An organization formed to be a social welfare organization that fails because it conducts too much political activity is classified as a taxable organization.<sup>223</sup> If the organization follows correct procedures, however, by filing a notice with the Service, it would be exempt as a political organization under section 527.<sup>224</sup> A section 527 political organization pays tax on its net investment income and is otherwise exempt from income tax.<sup>225</sup> Importantly, no section in the Code makes it illegal to speak or organize. Thus, the regime being enforced with respect to the Tea Party was simply a matter of classifying the organization as taxable or tax-exempt. Additionally, and importantly in understanding a part of the political battle taking place with respect to the Tea Party matter, a section 527 organization must disclose its donors while a social welfare organization is not required to make this disclosure.<sup>226</sup> Many political operatives choose to form social welfare organizations to advocate for campaigns in order to provide anonymity to their donors.<sup>227</sup> The money placed into social welfare organizations for this purpose is often referred to as “dark money.”<sup>228</sup>

In conclusion, while the law regarding social welfare organizations presents some administrative challenges for the Service, some amount of

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<sup>221</sup> There is no provision comparable to section 508 that applies to social welfare organizations. Rev. Rul. 80-108, 1980-1 C.B. 119, available at <http://www.irs.gov/pub/irs-tege/rr80-108.pdf> (last visited Apr. 12, 2015), archived at <http://perma.cc/QEC3-LW8V>; see also Rev. Rul. 81-177, 1981-2 C.B. 132 (last visited Apr. 12, 2015), available at <http://www.irs.gov/pub/irs-tege/rr81-177.pdf>, archived at <http://perma.cc/X876-79Y9> (finding that organizations that were not exempt from federal income tax under section 501(c)(3) because the organization failed to file a notice under section 508, might still have qualified during that period as an organization described in section 501(c)(4)).

<sup>222</sup> The Service computer system has in the past not accepted a Form 990 from an organization that it has not recognized through an application. HILL & MANCINO, *supra* note 46, at 32.03. This appears to not be a problem, though, today. I.R.S. Serv. Center Advice 200046038, at 4 (Sept. 27, 2000), <http://www.irs.gov/pub/irs-wd/0046038.pdf>, archived at <http://perma.cc/2F46-Q25Q>. Service should not reject Form 990s of organizations that are not required to file applications to be recognized as tax exempt.

<sup>223</sup> 26 U.S.C. § 527(f) (2012).

<sup>224</sup> *Id.*

<sup>225</sup> *Id.*

<sup>226</sup> *Id.* § 527(j).

<sup>227</sup> Donald B. Tobin, *Campaign Disclosure and Tax-Exempt Entities: A Quick Repair to the Regulatory Plumbing*, 10 ELECT. L.J. 427, 428 (2011).

<sup>228</sup> E.g., Heather K. Gerken, Wade Gibson & Webb Lyons, *Rerouting the Flow of ‘Dark Money’ into Political Campaigns*, WASH. POST (Apr. 3, 2014), available at [http://www.washingtonpost.com/opinions/rerouting-the-flow-of-dark-money-into-political-campaigns/2014/04/03/1517ac6e-b906-11e3-9a05-c739f29ccb08\\_story.html](http://www.washingtonpost.com/opinions/rerouting-the-flow-of-dark-money-into-political-campaigns/2014/04/03/1517ac6e-b906-11e3-9a05-c739f29ccb08_story.html), archived at <http://perma.cc/VG7R-JTP7>.

political activity will disqualify a nonprofit from qualifying as a tax-exempt social welfare organization. Many of these organizations made their deep connection to politics by adopting the term party in their name. Thus, the Service's interest in the Tea Party organizations' applications, very explicitly involved in politics, made sense.

#### IV. POSSIBLE LEGAL BASES FOR PROHIBITING THE USE OF NAMES AS A SCREENING PROCESS

It is not entirely clear from the IG report why the IG believed that using names to screen applications violated any legal or ethical norm. The report suggests that using names could lead to a belief that the Service was operating in an impartial manner, and also that it could lead to inconsistent results.<sup>229</sup> The IG does not identify a legal violation, but suggests primarily the violation of an ethical norm.<sup>230</sup> The IG cites IRS Policy Statement 1-1, which provides "IRS employees accomplish this mission by being impartial and handling tax matters in a manner that will promote public confidence."<sup>231</sup> To try to examine in greater detail possible violations of legal or ethical norms in utilizing names, this Article considers three possible violations the IG might have intended.

First, the IG might have believed the Service simply pulled organizations by name for closer review without taking into consideration whether they might have legally deserved a closer review ("first proposition"). The IG stated that screening should only be based upon legal requirements rather than upon name or policy position.<sup>232</sup> This statement suggests the IG might believe the Service needs some probable-cause-like standard before subjecting an organization's application to closer scrutiny. Under this view, the Service created inconsistent taxpayer results by randomly picking names to apply closer scrutiny. Agents operated much like airport security who randomly check individuals coming through security. Or, perhaps, the Service unfairly subjected certain organizations to further scrutiny without reason to believe these organizations needed more scrutiny. However, as discussed above, there is no evidence to support this proposition that the Service choice was entirely random in its selection of these organizations. Thus, the analysis will focus primarily on the next two possible claims the IG might be making.

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<sup>229</sup> IG Report, *supra* note 2, at 2.

<sup>230</sup> *Id.* at 5.

<sup>231</sup> *Id.* at 6.

<sup>232</sup> *Id.* at 11.

Second, the IG might have believed that pulling applications by name resulted in unequal enforcement of the law through inconsistent treatment of organizations applying for exempt status (“second proposition”). By focusing on organizations by name, the Service may fail to apply the law to similarly situated organizations that are potentially violating the Code. Under this theory, the problem with using the Tea Party name is that it means the Service will enforce the law in full against all Tea Party organizations, but it may miss some other similarly situated organizations. Under this theory, the Service should never use names because it might result in an unequal enforcement of the law on any application type. This violation assumes, in effect, that the Service must in the operation of its application system achieve what Judge Friendly called “the most basic principle of jurisprudence that ‘we must act alike in all cases of like nature.’”<sup>233</sup>

Finally, the IG might have meant something similar but narrower. The IG might have meant that in this particular instance the use of names was improper because of potential constitutional implications (“third proposition”). The Service picked conservative organizations by name to enforce a Code requirement that arguably involved the right to speak in our political system. The IG might have meant that the use of names in this instance was particularly harmful because this could lead to unequal enforcement on an issue that cannot be subject to unequal enforcement. Namely, this particular enforcement might have violated the First Amendment of the Constitution by subjecting some organizations to a different standard because of the content of their speech.<sup>234</sup>

The first two propositions implicate sub-Constitutional duties of an agency, while the third proposition implicates Constitutional duties. In the former, a court seeking to review such an action would need authority of a statute to do so. In the latter, the Constitution provides the court that right.<sup>235</sup> This Part will show that the Service can legally and ethically use names to screen applications. The review validates the third proposition as the primary limitation on the use of names in screening applications. Where the Service is enforcing a provision that implicates a fundamental constitutional right it must exercise greater care to ensure it is not engaged, nor does it look to be engaged, in some unequal enforcement of an important right.<sup>236</sup>

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<sup>233</sup> Henry J. Friendly, *Indiscretion About Discretion*, 31 EMORY L.J. 747, 758 (1982).

<sup>234</sup> U.S. CONST. amend I.

<sup>235</sup> *Id.*

<sup>236</sup> IG Report, *supra* note 2, at 1.

In considering these propositions, this Section considers legal and ethical thought that could have a bearing on the Service's exercise of discretionary authority in using names to screen its application system. It is relatively easy to show whether a legal violation occurred or not. There is little positive law addressing that question. As noted, only under a very narrow constitutional case can it be shown that the use of names to screen applications can result in the violation of the law.<sup>237</sup> It is not so easy to determine what should ethically guide the Service.

In developing the ethical case, this Part takes a cue from the argument of Professor John Rohr that regime values should guide a bureaucrat in exercising discretion.<sup>238</sup> Rohr makes the case that because bureaucrats are unelected officials, and they are making policy decisions in their discretionary actions, it is important that bureaucrats be trained to understand and apply important values of a governmental system.<sup>239</sup> He argues these important values are contained in public law.<sup>240</sup> Further, he contends that those principles can be found in Supreme Court opinions and can enrich our understanding of the ethical obligations of bureaucrats.<sup>241</sup> This Article pushes this idea further and assumes that our laws adopted by Congress and their interpretation by the courts tell us something significant about regime values and therefore ethical principles that should guide bureaucrats in exercising discretion. Thus, although there is neither a positive law, nor an agency rule, that would deem the use of names to violate law or ethics, we can extrapolate from general principles derived from these regime values.

This Part also proceeds on the presumption that we grant discretion to bureaucrats to do justice in some sense. As Professor Davis discussed in *Discretionary Justice*, there is a continuum over which we may view the scope of discretion provided to bureaucrats.<sup>242</sup> We may give them total unfettered discretion or we may determine their every action through explicit rules. Both poles present problems. Total unfettered discretion leads to tyranny because the bureaucrat is accountable to neither law nor political repercussions. However, law that guides every action prevents individualized justice.<sup>243</sup> With rules that are too rigid, bureaucrats lose the ability to make adjustments where adjustments are called for.

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<sup>237</sup> *Id.* at 5.

<sup>238</sup> JOHN A. ROHR, *ETHICS FOR BUREAUCRATS: AN ESSAY ON LAW AND VALUES* 68 (2d ed. 1989).

<sup>239</sup> *Id.* at 2-6.

<sup>240</sup> *Id.* at 73.

<sup>241</sup> *Id.* at 4-5.

<sup>242</sup> DAVIS, *supra* note 6, at 52-54.

<sup>243</sup> Cass Sunstein, *Problems with Rules*, 83 CAL. L. R. 953, 973 (1995).

Discretion is also granted to agencies particularly in the enforcement arena, because as the Court in *Heckler v. Chaney* recognized, the agency is likely the best judge of its limited resources to take enforcement action.<sup>244</sup> Given the significant lack of resources in carrying out the EO determinations function, we should grant the Service significant discretion in the enforcement decisions it makes. This properly balances the two often-opposed values of individualized justice and group justice. Utilizing names as a screening method would appear to fit well within that discretionary space.

A. *What We Can Learn from Courts Reviewing Similar Agency Action*

In establishing the base legal and ethical case, this Article starts by asking the degree of latitude Congress and courts provide to an agency in carrying out its particular function. We can establish that degree of latitude by considering the limits of jurisdiction provided to courts and the standard of review courts use to review that particular agency action. Those choices tell us something significant about where we as a society have struck the ethical and legal balance in the operation of a particular agency function. As discussed in Part II.A.3, Congress grants the Service substantial space to carry out the collection of revenue. It generally only grants court's jurisdiction to review Service action after a taxpayer has paid a tax, or after the Service has assessed a tax.<sup>245</sup> Additionally, the Anti-Injunction Act generally further prohibits a court from accepting jurisdiction before final Service action.<sup>246</sup> This indicates a high regime value priority on the collection of revenue. This choice arguably does not indicate a lack of concern for individualized rights, but it recognizes that if we focus too intensely on those individualized rights we will undermine fairness in a global sense.

1. What Standard of Review Might a Court Use in the Tea Party Matter?

Courts apply different levels of standard of review to agency action depending on the category of agency action. Those standards of review were developed through the common law, but are now generally set by statute by the Administrative Procedure Act.<sup>247</sup> The standard of review can run from *de novo*, when there is an explicit law defining agency

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<sup>244</sup> 470 U.S. 821, 827 (1985).

<sup>245</sup> See *supra* Part II.A.3 (discussing the exemption procedure).

<sup>246</sup> See *supra* note 102 and accompanying text (discussing the Anti-Injunction Act).

<sup>247</sup> 5 U.S.C. § 706(2)(A) (2012).

action, to no review at all, as is typical in the case of the question of whether or not to enforce the law in a particular case.<sup>248</sup>

Under the Administrative Procedure Act, the Service engages in informal adjudication when it reviews an application for a determination.<sup>249</sup> A court reviewing factual and policy determinations made by an agency as part of an order from an informal adjudication reviews those decisions under the fairly minimal arbitrary and capricious standard of review.<sup>250</sup> As the Supreme Court has stated, a reviewing court should make a “consideration of the relevant factors and whether there has been a clear error of judgment. . . . Although this inquiry into the facts is to be searching and careful, the ultimate standard of review is a narrow one. The court is not empowered to substitute its judgment for that of the agency.”<sup>251</sup> Thus, courts and Congress believe agencies should have great leeway in conducting such informal adjudications. Put another way, courts must generally accept a final result if it is a plausible result under the law.

The oddity of trying to apply this standard to the Tea Party matter is that this is a standard that applies to the review of final agency action.<sup>252</sup> In the Tea Party matter, almost none of these organizations had yet received denials of exempt status. But, courts typically look at decisions made as part of an informal adjudication after the agency has issued an order, not while administrative process is ongoing.<sup>253</sup> A court reviewing agency action is generally concerned with whether the final answer is correct.

Given that final action is typically necessary for judicial review, arguably, as long as the Service utilizes legitimate criteria when reviewing applications for exemption, its actions should be considered presumptively lawful. This notion is akin to the Court’s holding in *Heckler v. Chaney*. There, the Court established a presumption that an agency’s decision not to prosecute or enforce is immune from judicial review as a decision committed to complete agency discretion.<sup>254</sup> The Court noted that great discretion is granted in the case of decisions not to enforce because an agency has limited resources and has to make

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<sup>248</sup> *Id.*

<sup>249</sup> Steve R. Johnson, *Reasoned Explanation and IRS Adjudication*, 63 DUKE L.J. 1771, 1779 (2014).

<sup>250</sup> § 706(2)(A).

<sup>251</sup> *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 416 (1971).

<sup>252</sup> *See, e.g., Heckler v. Chaney*, 470 U.S. 821, 828 (1985) (providing that the APA calls for review of final agency action).

<sup>253</sup> *Id.*

<sup>254</sup> *Id.* at 832.

judgments about how to best marshal those resources.<sup>255</sup> Furthermore, the activity of enforcement itself has long been considered core executive power.<sup>256</sup> Both of these rationales would appear to apply in a similar manner to the use of names to screen applications. In effect, the choice to screen applicants is to make judgments about whom to enforce the law against. The Court's holding in *Hernandez*, discussed in Part IV.A.2.b below, provides further support for the proposition of a presumption in favor of the Service in its enforcement choices with respect to reviewing applications.<sup>257</sup>

The message contained in court and congressionally-placed limits on court jurisdiction to review Service action suggests problems with the first and second propositions. Those propositions seem to significantly limit the discretion of the Service in carrying out its functions related to the collection of revenue. That is inconsistent with the approach of courts and Congress.

## 2. What Laws Might Specifically Apply to Prohibit the Use of Names to Screen Applications

### a. *Impermissible Viewpoint Discrimination*

A typical complaint against the regime of tax exemption is that it impermissibly restricts taxpayer's First Amendment rights to speak. The Code only provides exemption to certain nonprofits including social welfare organizations when they give up some of their rights to lobby or to intervene in a political campaign.<sup>258</sup> Despite these claims of unconstitutionality, the Court has generally found the speech limitations applicable to tax exempt organizations to be constitutional.<sup>259</sup> The Court has determined that tax exemption is a subsidy and no organization has a right to subsidized speech.<sup>260</sup>

Nevertheless, the Service could, through how it administers the law, violate First Amendment rights. If the Service prohibited the speech of some but permitted speech to others it would almost certainly violate the First Amendment.<sup>261</sup> "Necessarily, then, under the Equal Protection Clause, not to mention the First Amendment itself, [the] government may not grant the use of a forum to people whose views it finds

<sup>255</sup> *Id.* at 831-32.

<sup>256</sup> *Id.* at 832.

<sup>257</sup> *Hernandez v. Comm'r*, 490 U.S. 680, 684 (1989).

<sup>258</sup> *See supra* Part II (discussing the legal requirements for social welfare organizations).

<sup>259</sup> *Regan v. Tax'n with Representation*, 461 U.S. 540, 544 (1983); *cf.* *Big Mama Rag, Inc. v. United States*, 631 F.2d 1030, 1040 (D.C. Cir. 1980).

<sup>260</sup> *Id.*

<sup>261</sup> *Police Dept. of City of Chi. v. Mosley*, 408 U.S. 92, 96 (1972).

acceptable, but deny use to those wishing to express less favored or more controversial views."<sup>262</sup>

There is no doubt that if the Service were to deny exempt status to organizations with conservative views solely because of those organizations' conservative views, it would be acting unconstitutionally. This First Amendment approach begins to build a case to support the third proposition.<sup>263</sup> It would not support the broader critique, however, laid out in the first or second propositions.<sup>264</sup>

*b. Selective Enforcement*

A claim of selective enforcement is the most direct legal claim that can be made against the Service for the use of names in screening applications. The equal protection and due process clauses as applied to the federal government through the Fifth Amendment protect against federal government selective enforcement.<sup>265</sup> However, the Court recognizes that agencies must make enforcement decisions and so sets the standard high for establishing a claim to selective enforcement.<sup>266</sup> "[T]he conscious exercise of some selectivity in enforcement is not in itself a federal constitutional violation[.]" there must be a showing that "the selection was deliberately based upon an unjustifiable standard such as race, religion, or other arbitrary classification."<sup>267</sup>

Although selective enforcement is a concept derived from criminal law, it has been applied in criminal tax and in civil tax audits, as well as to settlements.<sup>268</sup> In *Penn-Field Industries, Inc. v. Commissioner*, the Tax Court held, consistent with the principle stated by the Court in *Oyler*, that a taxpayer must prove: (1) that other similarly situated taxpayers were not selected for audit for the same reason; and (2) that this discriminatory selection was based on race, religion, or based on the desire to prevent constitutional rights.<sup>269</sup>

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<sup>262</sup> *Id.*

<sup>263</sup> See *supra* note 261 and accompanying text (providing a discussion on the First Amendment approach).

<sup>264</sup> See *supra* notes 232-34 and accompanying text (considering the possible violations the IG might have intended).

<sup>265</sup> See, e.g., *Bolling v. Sharpe*, 347 U.S. 497, 498 (1954) (exemplifying that the equal protection clause and due process clause of the Fifth Amendment prohibit racial segregation of school in the District of Columbia).

<sup>266</sup> *Oyler v. Boles*, 368 U.S. 448, 456 (1962).

<sup>267</sup> *Id.*

<sup>268</sup> See Steve R. Johnson, *The Selective Enforcement Defense in Civil and Criminal Tax Cases*, 27 A.B.A. SECTION OF TAX'N NEWS QUARTERLY 14 (Winter 2008) (discussing the scope of selective enforcement in criminal tax and civil tax audits).

<sup>269</sup> 74 T.C. 720, 723 (1980); see *An IRS Duty of Consistency*, *supra* note 11, at 590 (discussing the two-prong test); *The Selective Enforcement Defense in Civil and Criminal Tax Cases*, *supra*

Courts have evaluated a few selective enforcement cases associated with the charitable contribution deduction. Those decisions are instructive in how a court might view this Tea Party matter. In *Hernandez v. Commissioner*, for instance, the Service denied charitable contribution deductions claimed by Scientology adherents.<sup>270</sup> The Scientologists claimed that the Service selectively enforced a limitation on charitable contributions against those who practiced the Scientology religion but not against other religious adherents.<sup>271</sup> The Court acknowledged that the lower courts found no showing of “the type of hostility to a target of law enforcement that would support a claim of selective enforcement.”<sup>272</sup> The Court also rejected the Scientologists’ arguments that they should be able to deduct payments for religious activities because other faiths got to do the same.<sup>273</sup> The Court found first that the merits of deductions by other religious adherents were not before the Court.<sup>274</sup> Secondly, the Court determined that the Scientologists’ requested deductions simply did not meet the requirements of the law to be entitled to a charitable contribution deduction, the Court dismissed the assertion.<sup>275</sup> Without a showing of some animus and with an understanding that the Service appeared to be applying a reasonable interpretation of the law, the Court saw no claim for selective enforcement.<sup>276</sup>

The selective enforcement analysis simply does not support a case that using names as a screening tool is *prima facie* problematic. We again see courts provide the Service substantial discretion in carrying out its enforcement activities. Selective enforcement applies only when: (1) an agency does not apply similar treatment to similar organizations; and

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note 268, at 14 (discussing the support needed to defend a claim of selective or discriminatory prosecution).

<sup>270</sup> 490 U.S. 680, 686 (1989).

<sup>271</sup> *Id.*

<sup>272</sup> *Id.* at 700 (citing *Graham v. Comm’r*, 822 F.2d 844, 853 (9th Cir. 1987)) (internal quotation marks omitted).

<sup>273</sup> *Id.* at 698.

<sup>274</sup> *Id.* at 699.

<sup>275</sup> *Id.*

<sup>276</sup> *Hernandez*, 490 U.S. at 699. Admittedly, some courts have found that the Service inconsistently applies the law to different religious groups. Shortly after *Hernandez*, the Eleventh Circuit found in another Scientology case that the Service may have acted in an administratively inconsistent manner on an issue of religion. *Powell v. United States*, 945 F.2d 374, 377–78 (11th Cir. 1991). The Court in *Powell* found that the plaintiff was due a hearing as to whether this violated the plaintiff’s important constitutional rights. *Id.* at 377; see *Sklar v. Comm’r*, 282 F.3d 610, 612 (9th Cir. 2002) (determining the Service policy to allow deductions to Scientologists but not to other religions discriminatory and had no justification, but the Sklar family lost anyway because the tuition payment was not deductible).

(2) a constitutional right is at stake. In most contexts, neither prong will hold true. The Service is not likely enforcing the law in a selective manner, and maybe more importantly for this analysis, it is unlikely that constitutional rights are at stake in most attempts to enforce the Code. However, where the Service is applying a law that implicates a Constitutional right, such as freedom of speech or free exercise of religion, as was arguably the case in the Tea Party matter, greater care is called for. This suggests a regime value that from an ethical standpoint should guide the Service in administering its application system.

There are legitimate reasons the Service might choose to screen organizations based on name. An attempt to achieve uniformity of result is a legitimate reason to screen on the basis of name. Where organizations connected are complex, or present complex or challenging questions to the Service, the use of names to ensure evenhanded enforcement with respect to those organizations seems axiomatic. Additionally, the use of a name to identify replicated organizations that the Service has reason to believe are violating a Code section should also provide a legitimate basis for screening on the basis of name. The key for the Service for properly using names under selective enforcement guidance would be to first ask whether a particular Code section in the way it is being enforced implicates a Constitutional right. If it does, then the Service should work to establish a record of uniform treatment to all organizations subject to enforcement under that particular Code section.<sup>277</sup> This Section most directly undermines any support for the first or second proposition and supports in full the third.

*c. Duty of Consistency*

This Section considers an only tangentially related subject. However, it is important because it seems likely that this theory underlies the IG's concern regarding the manner of screening in the Tea Party cases. Some courts have found that the Service has a duty of consistency.<sup>278</sup> The duty of consistency is based on Justice Frankfurter's announced principle that the "Commissioner cannot tax one and not tax another without some rational basis for the difference."<sup>279</sup> This theory is closely related to the selective enforcement cases above; however, under

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<sup>277</sup> This approach could present significant resource challenges too—as the Service comes upon such enforcement challenges, it should reconsider its approach to the issue.

<sup>278</sup> *See, e.g.,* United States v. Kaiser, 363 U.S. 299, 308 (1960) (Frankfurter, J., concurring) (referring to Justice Frankfurter's concurring opinion, where he discusses equal tax treatment).

<sup>279</sup> *Id.*

this version, there is no need for a constitutional right to be at stake.<sup>280</sup> Thus, were we to extend this theory to the question of the Service using names to screen applications, we might be able to support the second proposition, and maybe even the first.

In the classic duty of consistency case, the Service issued a private letter ruling to Remington stating that Remington did not owe tax on the sale of certain machines.<sup>281</sup> IBM asked for the same ruling because it sold the same type of machines, but the Service denied IBM's request.<sup>282</sup> The Claims Court determined that it could review the decision of the Service for an abuse of discretion.<sup>283</sup> Finding that "[e]quality of treatment is so dominant in our understanding of justice that discretion, where it is allowed a role, must pay the strictest heed," the Court held that the Service abused its discretion by not treating IBM in the same way it treated Remington.<sup>284</sup>

This case has not been widely followed. Congress and courts recognize the Herculean task that maintaining absolute consistency would mean given the available Service resources.<sup>285</sup> For instance, Judge Friendly has stated, "[w]hile even-handed treatment should be the Commissioner's goal, perfection in the administration of such vast responsibilities cannot be expected. The making of an error in one case, if error it was, gives other taxpayers no right to its perpetuation."<sup>286</sup> Furthermore, as the Claims Court held in a case soon after the IBM matter:

It is a settled principle of law that the United States is not bound by the unauthorized acts of its agents, that it is not estopped to assert the lack of authority as a defense, and that persons dealing with an agent of the

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<sup>280</sup> See Richard A. Epstein, *What Do We Mean by the Rule of Law?*, N.Z. BUS. ROUNDTABLE, Aug. 2005, at 2-3 (stating that similarly situated individuals should be treated similarly, avoiding arbitrary and capricious decisions).

<sup>281</sup> *Int'l Bus. Mach. Corp. v. United States*, 343 F.2d 914, 924-25 (Ct. Cl. 1965).

<sup>282</sup> *Id.* at 929.

<sup>283</sup> *Id.* at 920.

<sup>284</sup> *Id.*

<sup>285</sup> See, e.g., *Sirbo Holdings, Inc. v. Comm'r*, 509 F.2d 1220, 1222 (2d Cir. 1975) (discussing the near impossibility of absolute consistency).

<sup>286</sup> *Id.* (citations omitted); see *Wagner v. United States*, 387 F.2d 966, 968 (providing that the Commissioner may change a former practice if he believes it is wrong); *Snowden v. Hughes*, 320 U.S. 1, 15 (1944) (Frankfurter, J., concurring) ("The Constitution does not assure uniformity of decisions or immunity from merely erroneous action, whether by the courts or the executive agencies of a state.").

government must take notice of the limitations of his authority.<sup>287</sup>

Scholars recognize that courts apply the duty of consistency inconsistently. As pointed out by Professor Johnson, most cases limit the IBM and Remington precedent to situations where two conditions are present: (1) two taxpayers are in competition; and (2) the taxpayer denied a favorable ruling claims the Commissioner abused his discretion by failing to apply a new legal position only prospectively.<sup>288</sup> Professor Johnson refers to three principal duty of consistency views: (1) a “strong duty”; (2) “no duty”; and (3) a “weak duty.”<sup>289</sup> Under the strong duty view, even if the Service position being asserted is the correct state of the law, a court will find for the taxpayer if the Service practice has been contrary to the state of the law and favorable to the taxpayer.<sup>290</sup> Under the no duty view, while there may be some moral or ethical compulsion that the Service treat taxpayers similarly, such a duty is not judicially enforceable.<sup>291</sup> Finally, under the weak duty views, courts either believe that the duty only applies under certain circumstances, or the remedy does not necessarily mean the taxpayer wins.<sup>292</sup>

What is important, however, is to distinguish consistency of result from consistency of process. The case law and Professor Johnson’s scholarship concerns the former and not the latter. First, given the level of discretionary authority the Service has in the area of enforcing exemption, under even the weak level of duty of consistency, the Service probably has a duty to treat taxpayers as similarly as possible. It should make every effort to apply the law consistently to inspire taxpayer confidence in the impartiality of the Service. However, the duty of consistency has nothing to say about enforcement discretion of the Service.

Second, a duty of consistency applies only in situations where the Service provides a final positive decision to one group and denies it to another. The use of names in screening organizations does not do this.

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<sup>287</sup> *Bornstein v. United States*, 345 F.2d 558, 562 (Ct. Cl. 1965).

<sup>288</sup> See *The Selective Enforcement of Defense in Civil and Criminal Tax Cases*, *supra* note 268, at 578 (citing *Vons Cos. v. United States*, 51 Fed. Cl. 1, 10 (2001)) (noting the two limited conditions where the IBM and Remington precedent are applicable).

<sup>289</sup> *Id.* at 580.

<sup>290</sup> See, e.g., *Vesco v. Comm’r*, 39 T.C.M. (CCH) 101, 129 (1979) (holding that even though the state of the law meant that the value of flights of family members should be included in income, because the Service had a practice of not treating this as income, the court rejected the Service’s position in the case).

<sup>291</sup> *The Selective Enforcement of Defense in Civil and Criminal Tax Cases*, *supra* note 268, at 583.

<sup>292</sup> *Id.* at 584.

Using names to screen for organizations does not implicate the question of whether the Service is applying the same precedent. The duty of consistency puts a premium on consistency of *result*. Arguably, if the Service does not utilize names as a means of screening applicants that are related, it likely increases inconsistency of result within that group of organizations. If it does use names, however, it may at times treat the named organization differently than it treats non-named organizations, but only in process, not in result. As a result of Service resources, there is likely to be a lack of consistency of process treatment no matter what direction the Service takes. Arguably, however, that the use of names should ultimately result in greater consistency of result, which is what should be the concern. By increasing the expertise of its staff with particular organizations and issues, the Service should be pushing closer to the underlying goal of all of the duty of consistency cases—the fair treatment of taxpayers by a consistent application of the law. Thus, support for only the third proposition is to be found in the duty of consistency line of thought.

### 3. Other Considerations

The following topics are tangential considerations regarding employee discretion and the use of names for screening that help to further the support for the third proposition.<sup>293</sup> These also are items that need to at least be considered as relevant to the Tea Party matter.

#### *a. Application of 1998 Restructuring Act Principles*

Congress has significantly restructured the Service four times.<sup>294</sup> The complaints that the Service can never shake are that it is secretive, inefficient, and mistreats taxpayers.<sup>295</sup> All three complaints are found in the Tea Party matter. These complaints also inspired the last restructuring of the Service, and, thus, it is important to at least consider the impact that the restructuring should have had on the way the Service operated in this instance.<sup>296</sup>

In the Internal Revenue Service Restructuring and Reform Act of 1998 (“Reform Act”), Congress restructured the Service to remedy what

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<sup>293</sup> See *infra* Part IV.A.3.a-b (applying the 1998 Restructuring Act principles and analyzing unnecessary examinations).

<sup>294</sup> Thorndike, *supra* note 11, at 718.

<sup>295</sup> *Id.*

<sup>296</sup> See *infra* notes 297-300 and accompanying text (explaining the Reform Act of 1998).

it saw as employee abuses of taxpayers.<sup>297</sup> The Reform Act broadly worked to change Service organization and management, mode of Congressional oversight, electronic filing, and most important for this part, created new taxpayer protections and rights.<sup>298</sup> Of importance to the consideration of this Article, the Act created what are often referred to as the Ten Deadly Sins of a Service employee.<sup>299</sup> These sins result in automatic termination of an employee.<sup>300</sup> Thus, are any of the Ten Deadly Sins applicable to the case of a Service employee screening applications?

The sins most likely implicated include three, six, and ten. Deadly Sin Three prohibits “with respect to a taxpayer, taxpayer representative, or other employee of the Internal Revenue Service, the violation of (A) any constitutional right or (B) any civil right established under certain specified statutes, such as the Civil Rights Acts.”<sup>301</sup> Deadly Sin Six involves the willful violation of the Code or regulations or Service policies to retaliate or harass a taxpayer.<sup>302</sup> Finally, Deadly Sin Ten prohibits the threat of an audit to extract political gain or benefit.<sup>303</sup>

There is nothing in the use of names to screen applications that would suggest a prima facie violation of any of the Deadly Sins. Screening could rise to that level, but again, there would need to be some animus in the decision of the Service to use the names for some ulterior motives. In the vast majority of cases, it seems unlikely that Service employees would use names in this manner. Nevertheless, in using names in the screening process, the Service may want to impose some checks to ensure that the names are not being used for improper purposes. The IG made what is probably a good suggestion in its report that the BOLO listing should be approved at a higher level than in the Cincinnati office.<sup>304</sup>

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<sup>297</sup> Pub. L. No. 105-206, 112 Stat. 685 (1998); see, e.g., Thorndike, *supra* note 11, at 765 (stating that Congress reformed the IRS in 1998).

<sup>298</sup> JOINT COMM. ON TAX’N, REPORT OF THE JOINT COMM. ON TAX’N RELATING TO THE IRS AS REQUIRED BY THE IRS REFORM AND RESTRUCTURING ACT OF 1998, 1 (May 4, 2001), available at <http://www.jct.gov/x-33-01.pdf>, archived at <http://perma.cc/6X78-5X8Z>.

<sup>299</sup> Internal Revenue Service Restructuring and Reform Act of 1998, 26 U.S.C. § 7804 (2012).

<sup>300</sup> *Id.* § 7804(b)(3).

<sup>301</sup> *Id.* § 7804(b)(6).

<sup>302</sup> *Id.*

<sup>303</sup> *Id.* § 7804(b)(10).

<sup>304</sup> IG Report, *supra* note 2, at 10.

*b. Unnecessary Examinations*

Section 7605(b) prohibits the Commissioner from conducting unnecessary examinations.<sup>305</sup> The rule regarding unnecessary examinations does not apply to the determinations function because the latter is not an examination.<sup>306</sup> It seems reasonable to conclude, however, that the law regarding unnecessary examinations could at least be ethically instructive to Service agents managing the determinations process. What we find again is strong support for the third proposition.

The leading case on section 7605(b) is *United States v. Powell*, where the Court held that the idea of necessity within section 7605(b) did not contemplate a showing of probable cause to conduct an examination for fraud.<sup>307</sup> The Court considered the history of the statute and concluded that, while Congress enacted it to ensure that the Service needed to conduct an examination, it did not intend to import a particularly high burden for the Commissioner.<sup>308</sup> The Court's discussion of that history is instructive:

Congress recognized a need for a curb on the investigating powers of low-echelon revenue agents, and considered that it met this need simply and fully by requiring such agents to clear any repetitive examination with a superior. For us to import a probable cause standard to be enforced by the courts would substantially overshoot the goal which the legislators sought to attain. There is no intimation in the legislative history that Congress intended the courts to oversee the Commissioner's determinations to investigate.<sup>309</sup>

The Court's guidance in *Powell* is that the Service should have substantial latitude in determining what and how much to examine.<sup>310</sup> It seems reasonable to believe that in the determinations process, such latitude should be granted as well. In that case, it seems perfectly acceptable to believe that the Service could use names to screen applications in ways mentioned above: (1) to achieve uniformity; or (2) where there is concern that a particular name may be associated with

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<sup>305</sup> § 7605(b).

<sup>306</sup> JOHN A. TOWNSEND, *FEDERAL TAX PROCEDURE* 256 (2d ed. 2013).

<sup>307</sup> *United States v. Powell*, 379 U.S. 48, 51 (1964).

<sup>308</sup> *Id.* at 53-54.

<sup>309</sup> *Id.* at 55-56.

<sup>310</sup> *Id.*

violations of the Code. Thus, again this provides no support for any of the propositions beside the third proposition.

#### V. APPLICATION OF ANALYSIS TO THE TEA PARTY SITUATION

##### A. *The Legal and Ethical Case*

This final Part considers how the above principles should apply to the actual Tea Party matter. Unlike the IG Report, this Part takes into consideration the management of Service resources. In the Tea Party matter, the Service made a decision about its resources and the law it enforces.<sup>311</sup> As established in Part II, Service resources are scarce and the Service has to make judgments regarding which applications to provide a closer review.<sup>312</sup> Additionally, the agency has individuals with the unique knowledge of the organization and its goals that place the agency in the best position to make these calls.

As the analysis in Part IV demonstrated, the primary theory that is potentially applicable to the Tea Party matter is a theory of selective enforcement.<sup>313</sup> A first observation is that the Service made no final determinations regarding the Tea Party organizations. The selective enforcement theme is used to attack a final negative determination generally, not typically an ongoing investigation. Thus, a question of selective enforcement does not have great application to these cases unless the Service should deny the Tea Party organizations while granting such status to similarly situated liberal organizations. While procedure on the margins is important, there should be a presumption of legitimate process where the Service gets to the right result.

If the Service issued denials in the Tea Party matter it would still be hard for a plaintiff to mount a successful selective enforcement case. The first step calls for a conclusion that the Service did not treat other organizations in a similar manner. Here, the fact that only about one third of the organizations identified in the audit were conservative organizations makes it difficult to get past the first step of the United States Tax Court's *Penn-Field* test for selective enforcement.<sup>314</sup> Additionally, the evidence is that the Service in a similar time period selected for review and issued denials to a Democratic women's

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<sup>311</sup> See *supra* note 244 and accompanying text (discussing *Heckler's* proposition that the Service is the best judge of its limited resources).

<sup>312</sup> See *supra* Part II (providing information on the responsibilities and resources of the Service for the determinations process).

<sup>313</sup> See *supra* Part IV (analyzing the legal bases for the issues with the determinations process).

<sup>314</sup> See *supra* note 269 and accompanying text (providing the test from *Penn-Field*).

organization.<sup>315</sup> Thus, on the basis of the evidence before the public, there is no evidence that the Service is applying the law in its final determinations in an inconsistent manner.

As for the second step, the requirements of section 501(c)(4) prohibit some political activity.<sup>316</sup> Thus, a case can be made that its enforcement at least implicates a constitutional right – the right to free speech and free association. However, nothing in the determination process stops an organization from speaking. The Service is only trying to determine a tax status and imposes no restrictions on speech. The only question is whether the organization is taxable or tax-exempt. Organizations willingly submit applications to the Service to be recognized as organizations exempt from income tax. Further, as the Court has recognized, there is no right to exemption from income tax.<sup>317</sup> Thus, while these cases touched on a constitutional right, the contention that these cases specifically impacted a constitutional right is weak. Thus, a legal case that the Service might have selectively enforced the law against the Tea Party groups is weak.

However, as established in Part III, US regime values suggest a strong ethical obligation on the part of Service employees to act with a high standard of care on a case that implicates a constitutional right.<sup>318</sup> Although the standard for a legal claim to selective enforcement should likely be higher, given the universal immediate response to the idea that the Service targeted the Tea Party, it seems reasonable to conclude that this is a sufficient enough connection to a constitutional right for ethical purposes. There is ample evidence that the Service did not operate with a high degree of care as it managed the Tea Party cases. While the Service appears to have put some significant amount of resources to work on these cases, the Service employees tended to manage them sloppily. There was a lack of clarity in instruction from management, and a tendency to forget about cases and take far too long in coming to a

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<sup>315</sup> See Stephanie Strom, *3 Groups Denied Breaks by the IRS are Named*, N.Y. TIMES (July 20, 2011), available at <http://www.nytimes.com/2011/07/21/business/advocacy-groups-denied-tax-exempt-status-are-named.html>, archived at <http://perma.cc/NG2R-TMTS> (detailing the story of the denial of social welfare organization status to three Democratic women's organizations); Joan Walsh, *Meet the Group the IRS Actually Denied: Democrats!*, SALON (May 15, 2013), available at [http://www.salon.com/2013/05/15/meet\\_the\\_group\\_the\\_irs\\_actually\\_revoked\\_democrats/](http://www.salon.com/2013/05/15/meet_the_group_the_irs_actually_revoked_democrats/), archived at <http://perma.cc/8BC5-T2LF> (detailing how the Service systematically denied and pulled exemptions from this Democratic women's group seeking status as social welfare organizations).

<sup>316</sup> 26 U.S.C. § 501(c)(4) (2012).

<sup>317</sup> See *supra* note 32 and accompanying text (discussing the process an organization must follow to be granted an exemption).

<sup>318</sup> See *supra* Part III (discussing the ethical obligations of Service employees and the higher standard of care expected of them).

decision. Additionally, the questions asked were at times overly intrusive. Furthermore, the Service sloppily managed a record of its efforts to manage liberal and conservative organizations with equal care.

The Service should establish a record of care of enforcement when managing cases associated with political activity to reestablish integrity in the determinations process. The Service could consider implementing this into its procedures in the IRM or in an annual revenue procedure. Additionally, the Service might consider adding to its annual training a discussion of ethics from a Constitutional perspective, rather than from the very rule based method it annually utilizes.

This analysis leaves a few questions for the Service to consider as it manages its Determinations Process. First, when the Service is screening for political advocacy organizations in its computer system, should it be forced to utilize a roughly “equal” number of tag-words referring to conservative and liberal organizations? My sense is that this would be a good practice on the part of the Service. This could help establish a record of evenhandedness.

Second, what if there is good reason to think that conservative organizations are making use of an organizational structure much more than liberal organizations—may the Service be permitted to focus more on conservative tag-words provided that it offers a sufficient justification for that choice? This is really related to the first question. Perhaps it should be phrased as, if it appears the Service is enforcing the law in greater number against conservative organizations, as was the apparent appearance in the Tea Party matter, is there a way for the Service to insulate itself from claims of selective enforcement. It seems the high degree of care would mandate what was stated as to the first question—that is, the Service should make strong efforts to ensure it maintains a list of all organizations from all political persuasions to ensure it is picking up the widest diversity of political organization possible.

Finally, should different constitutional standards give rise to different standards of justifications? In other words, does the Service have more leeway to target, say, a subset of religious organizations as opposed to a subset of political organizations, or race-based organizations? Given that the premise of this Article is that the standard of care for regular enforcement is one standard and the standard for enforcement when impinging on a constitutional right is higher, it stands to reason that the Service should apply different standards depending on the constitutional right involved. It probably should never screen on race-based standards. However, fortunately, and correctly, there are no race-based standards for qualifying for tax-exemption. Interestingly in the realm of religion, Congress has already provided significant

protections to churches.<sup>319</sup> Congress believes churches at least should be provided some extra protection from the Service.

*B. Recommendations Regarding the IG Based on This Analysis*

The IG, a creature of the 1998 Tax Restructuring Act, fills an important role. It helps provide critical analysis of Service functions. It is an important independent voice that can protect taxpayers from improper Service action, and can provide the Service a picture of problems that the organization is facing. However, in exercising this role, the IG needs to be more careful in anchoring its claims of violations by the Service in its proper legal, ethical, and policy context. The report on the Tea Party failed to anchor a major claim in anything more than a Service platitude. It also badly advised the Service in future action. Failing to use names in screening applications will lead to less consistency by the Service rather than more. The IG simply failed to consider all of the factors that needed to be balanced in issuing its report.

## VI. CONCLUSION

What mandate does Congress and constitutional law set for the Service in operating the EO determinations process? Arguably, it is to as quickly as reasonably possible correctly assess the applications it receives for exemption. The IG Report raises the question of what methods are appropriate to accomplish this function. What could guide the Service in this question? The IG suggests that it must use the standards from the Code and regulations in making screening decisions. However, given the Service's limited resources and heavy workload, this seems more likely to result in greater harm to uniformity and fairness of treatment than the system that the Service appears to have been utilizing. Eliminating a simple tool of allowing related organizations to be easily identified by name and considered together by the same agents seems more likely to result in non-uniform results.

This review of authorities overwhelmingly suggests that both Congress and courts believe a high degree of discretion should be granted to the Service as it collects revenue. Tax exemption directly implicates the collection of revenue since each organization granted exempt status is freed from having to contribute coin to the general welfare of the United States. Determination of exempt status is a necessary part of the system of revenue collection. In carrying out that

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<sup>319</sup> See, e.g., 26 U.S.C. § 7611 (2012) (restricting tax inquiries and examinations on churches).

function, the Service certainly has a duty to enforce the laws as impartially as possible. The use of names to screen applications in most instances should not suggest that the Service is acting impartially. The lesson of the Tea Party matter though is that in the case of political activity, the use of names may cause some to question the partiality of Service employees. This is not inconsistent with the way courts view selective enforcement. Where enforcement touches on a constitutional right, courts are more likely to find impermissible enforcement actions. This suggests that where the Service is enforcing a provision, such as the prohibition on too much political campaign activity, that the Service should establish a record that utilizing a name will result in more fair enforcement than not using a name. Additionally, it should ensure that it is making every effort to utilize names widely within that field of enforcement. Finally, while the Service engaged in no legal violation in utilizing names to screen the applications, its bumbling management of the application of a law that touches on important constitutional rights failed to meet ethical standards.