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Exempt Organizations

IRS Can Focus on Other Guidance As Exempt Political Activity Project Ends

The end of an IRS proposed rule on exempt political activity that garnered 170,000 comments was described as ''a blessing in disguise'' by several attorneys who have closely watched its development.

The Internal Revenue Service will ostensibly be freed up in 2016 to address long-standing and other guidance projects that have been pushed aside for other priorities, they told Bloomberg BNA.

In addition, the agency will finally get out of hot water with many advocacy groups that opposed its plan to address secret spending by tax code Section 501(c)(4) groups. The groups aren't required to disclose their donors to the public—but watchdog groups for years have said they should be.

''The IRS has suffered so much credibility damage from attempts to regulate the sector and this is an issue the voters have to decide,'' Alexander Reid, a partner with Morgan, Lewis & Bockius LLP, said. ''It's unfair to require the IRS to make that call. It's a lose-lose for them.''

So far the public at large hasn't expressed a great deal of interest in revamping campaign finance, Reid said. But he predicted the public's interest would be piqued when the lack of transparency leads to scandals as it did in the 1970s.

In the Consolidated Appropriations Act of 2016 (Pub. L. No. 114-113), Congress prohibited the Treasury Department and IRS from using any Treasury funding in the fiscal year ending Sept. 30, 2016, to issue, revise or finalize any regulations, revenue rulings or other guidance not limited to a particular taxpayer.

Off the Table. The action took one of the agency's biggest regulatory projects off the table—at least through the 2016 presidential election.

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MARCUS OWENS
LOEB & LOEB LLP

''It's a godsend. A Christmas gift. And the IRS ought to embrace it and not return it for another item,'' Marcus Owens, a partner with Loeb & Loeb LLP, said. If Treasury is wise it will point to the appropriations writer as the reason for closing down the regulation project, and move on, he told Bloomberg BNA.

The definitions in the rules weren't drafted with the actual state of the law in mind, Owens said. ''They were drafted with a very narrow view, a view created with blinders on,'' that looked only to trying to coordinate IRS definitions with Federal Election Commission definitions of what campaign-related finance is. The rules didn't take into account the actual grounds that have been used by the IRS to revoke or deny exemptions to politically active 501(c)(4)s, Owens said.

The IRS spent more than two years trying to create a definition of campaign-related political activity for social welfare groups. When the rules were finally proposed in November 2013, such an outcry ensued from both sides of the political aisle that the agency was forced to pull back the rules and promise to issue revised ones.

Some advocacy groups have been scanning the horizon for the rules ever since, and IRS Commissioner John Koskinen had said they might be proposed before the presidential election, but wouldn't be finalized by then. The IRS and Treasury declined to comment on the latest development.

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Disappointment. Democracy 21 is one of the groups disappointed at the loss of the project.

''Such regulations could have addressed the current problem of 501(c)(4) groups engaging in far more campaign activity than the law allows in order to launder hundreds of millions of dollars in secret contributions into federal elections,'' Fred Wertheimer, president of Democracy 21, said in a statement.

According to Public Citizen, it is only a one-year delay and the group will be pushing for the IRS to take the project up again once the funding bill expires in 2016.

''It's an important enough issue and the IRS has done so much work on it that they should come back to it,'' Emily Peterson-Cassin, coordinator of Public Citizen's Bright Lines Project, told Bloomberg BNA. The project was developed to clarify the definition of political activity for all nonprofits.

Charities have needed the clarification for decades, Peterson-Cassin said, and the problem goes beyond just the election. ''We are willing to wait for the right rules and we are confident that if the rulemaking is allowed to continue after September 2016 that we will get the clarity nonprofits have needed,'' she said.

The agency's proposed rules expanded the scope of the revised rules on campaign-related activity for 501(c)(4)s to also cover other types of exempt organizations, such as labor unions and trade associations.

More Work Under PATH Act. While year-end congressional action on spending and extenders took work away from the IRS with one hand, it added work with the other.

The Protecting Americans From Tax Hikes (PATH) Act (Division Q of Pub. L. No. 114-113) will mean new work for the IRS, Robert Wexler, a principal with Adler & Colvin LLP, told Bloomberg BNA.

The PATH Act requires Section 501(c)(4) organizations to notify the IRS of their formation within 60 days of their establishment, and the IRS is required to acknowledge that notice within 60 days of receipt.

''The new law will require 501(c)(4)s, minimally, to file some kind of form with the IRS notifying them that they exist. This means the IRS will have to come up with a new form,'' Wexler said. It will likely be a priority for the IRS in 2016.

That differs from current practice in which these organizations can set up shop and begin operating without getting approval of their tax exemption first.

The PATH Act also requires existing Section 501(c)(4) organizations that haven't filed Form 1024, Application for Recognition of Exemption Under Section 501(a), or Form 990, Return of Organization Exempt from Income Tax, on or before Dec. 18, 2015, to provide the notice within 180 days of that date.

New procedures will also have to be set up for administrative appeals for exempts that have received an adverse determination from the IRS, since the act provides for those appeals, Wexler said.

DAF Guidance, Finally? If there is one project practitioners would like to see substituted for the Section 501(c)(4) one that was scrapped, it is guidance regarding the excise taxes on donor-advised funds and fund management. This project has been on the IRS's business plan for many years and would address issues resulting from the Pension Protection Act of 2006.

''It's complicated and there are a lot of issues, but it's time for that to come out,'' Wexler said. There is a growing belief that donor-advised funds aren't providing a service, in that they are allowing wealthy people to set aside money, get a tax deduction, accumulate funds and not send them to charity, Wexler told Bloomberg BNA.

He also said he hopes the IRS will turn its attention to updating Revenue Procedure 92-94, which pertains to the reliance standards for making good faith determinations.

In proposed rules (REG-134974-12), the Treasury Department and the IRS said they are considering whether the current standards in Rev. Proc. 92-94 should be modified to take into account changes to the public support test for public charity status under Sections 170 and 509, and whether additional guidelines regarding appropriate time frames for gathering information upon which written advice is based should be provided in final rules or in guidance.

Another project that might see the light of day in 2016 is one under Section 4941 regarding a private foundation's investment in a partnership in which disqualified persons are also partners, Wexler said.

Redomestication Issue. Reid also said he hopes the IRS will either revise or revoke Revenue Ruling 67-390, which addresses when exempts move from one state to another. In general the guidance says if an exempt changes its state of incorporation, it must reapply for exemption with the IRS, Reid told Bloomberg BNA.

Yet in two 2014 private letter rulings—PLR 201426028 and PLR 201446025—Reid said the IRS said exempts can redomesticate without reapplying.

The process right now is too cumbersome, Reid said, with corporations having to liquidate and reincorporate as a new entity and then reapply to the IRS. ''It really limits organizations that feel stuck in a place they can't move from.''

Reid and others also said 2016 is the year that exempts should expect more computer-assisted correspondence audits. They said the IRS is moving toward a Form 990 that is as digital as possible so that it can use algorithms to identify issues and more broadly audit the exempt field.

''The spot-check deep dive that they do now involves too many organizations, too many issues, and doesn't result in enough revenue collections for the IRS,'' Reid said.

Compensation of exempt executives is one of the main areas the IRS is likely to mine for data, he said.

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