

## Articles

July 26, 2012

### Second in Series of Hearings on Tax-Exempt Sector Held by U.S. House of Reps. Ways and Means Subcommittee

Related Topic Area(s): Tax and Employee Benefits

**July 26, 2012** - Yesterday, the U.S. House of Representatives Ways and Means Oversight Subcommittee (the "Subcommittee") held its second hearing focusing on oversight of the tax-exempt sector. While the previous hearing held in May had offered industry representatives an opportunity to discuss a wide variety of topics related to all types of tax-exempt organizations, the purpose of this hearing was limited to issues regarding Section 501(c)(3) public charities, with a particular focus on the redesigned IRS Form 990, affiliated organization relationships, and the treatment of unrelated business income ("UBI").

The hearing consisted of two panels. The first panel had only one witness – **Steven Miller**, Deputy Commissioner for Services and Enforcement, Internal Revenue Service. The second panel featured the following witnesses: **Eve Borenstein** (Borenstein and McVeigh Law Office LLC), **Thomas Hyatt** (Partner, SNR Denton), **John Colombo** (Albert E. Jenner, Jr. Professor, University of Illinois College of Law), and **Donald Tobin** (Associate Dean for Faculty and Professor of Business Law, Ohio State University Moritz College of Law).

During the first part of the hearing, Mr. Miller spoke about the role of the Internal Revenue Service (the "Service") in overseeing the tax-exempt sector as primarily being that of a regulator as opposed to tax a collector. Mr. Miller enumerated some of the challenges faced by the Service in performing this role, including the fact that the Service must interpret laws for which there are rarely bright lines and the limited enforcement options available beyond revocation, which Mr. Miller described as a "draconian step."

The Subcommittee also questioned Mr. Miller on the redesign of the Form 990. Prior to the redesign, which went into effect with transitional rules for tax year 2008, the Form 990 had not been modified since 1979, a time when organizations were much simpler and smaller. When asked whether the Service was satisfied with the redesign, Mr. Miller replied that it was "a success" but acknowledged that the Form was a living document and some changes might need to be made to some parts considered overly burdensome. Mr. Miller also mentioned that changes in the Form 990 should at some point be carried over to IRS Forms 1023 and 1024, and that the threshold levels for when organizations may file the Form 990-N electronic postcard versus the Form 990-EZ or the full Form 990 could be "open for discussion."

Although the topic of the hearing was public charities, the Subcommittee also spent significant time questioning Mr. Miller on the approval process for 501(c)(4) social welfare organizations. Mr. Miller explained that the Service had received a large increase in Form 1024 applications from advocacy organizations seeking to be recognized as tax-exempt under Section 501(c)(4) and that these organizations had been grouped together so that the Service could ensure consistency in making its determinations. About 200 of such organizations were grouped together during the determination process; over 50 have received recognition of tax-exempt status and "more will." Mr. Miller said he was aware of some groups that claimed they felt harassed during the application process and commented that he hopes the "noise will lessen" as the Service continues to work through the determination process for certain advocacy organizations.

During the second panel, the Subcommittee questioned the academic and tax practitioners on similar topics as had been discussed with Mr. Miller. Regarding the Form 990 redesign, Ms. Borenstein, introduced by Chairman Charles Boustany (R-LA) as "the queen of the Form 990," commented that the extensive changes were much needed. Prior to the redesign, Ms. Borenstein explained, both the tax-exempt sector and the Service agreed that the Form 990 was a "disaster." Ms. Borenstein gave

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recommendations for future Form 990 reform efforts, including adding more educational instructions to the Form, streamlining Schedule F (the schedule that asks for information on international activities), and removing any references to the subjective distinction between fundraising and management expenses.

The Subcommittee also asked the second panel about lobbying and political activities of 501(c)(3) and 501(c)(4) organizations. Mr. Tobin explained that the problem in this area is that the Service has been put in charge of policing organizations' activities without being given effective tools. Notably, Mr. Tobin suggested that a possible solution would be for the Service to implement a public complaint process similar to the Federal Election Commission's, where the public can submit concerns, with the results of the Service's investigation being made publicly available. Currently, there is a process for submission of complaints, but once submitted, audits and other investigations by the Service remain strictly confidential.

The Subcommittee also was interested in the current use of related/affiliated organizations in the tax-exempt sector. At one point, Mr. Hyatt utilized a white board to illustrate for the Subcommittee a visual he referred to as "a simple complex structure of a public charity," such as one commonly employed by hospitals or universities, which utilizes a parent organization with related/affiliated taxable and tax-exempt entities. Mr. Tobin noted that for these types of organizational structures, the new Form 990's Schedule R – to be completed with information on related entities – was necessary to ensure that the significant subsidies given to tax-exempt organizations are not "pushed off" to non-tax-exempt related/affiliated organizations.

Finally, the Subcommittee engaged in extensive questioning of the witnesses regarding the unrelated business income tax ("UBIT"). After the witnesses collectively walked the Subcommittee through a hypothetical example involving a university which discovered oil on its campus and either leased the rights to a developer (no UBI because of the royalty exception), developed the oil itself (UBI because it is not related to the university's educational purpose), or utilized the oil in a class teaching students the mechanics of oil drilling (perhaps no UBI if it is demonstrated to be a related purpose for the university), Mr. Tobin suggested that the Service might instead consider doing away with the substantially related test and instead allow an unlimited amount of non-exempt commercial activity, with UBIT imposed on all income resulting from such activity.

The hearing concluded after approximately two hours. It is likely that additional hearings on other types of tax-exempt organizations will be scheduled, and Venable will continue to monitor and report the Subcommittee's activities regarding tax-exempt organizations.

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