INTRODUCTION

WHAT can be done to restore public trust in the IRS in the wake of the agency’s troubles in administering the exempt organization (“EO”) tax laws? This Essay proposes increasing the transparency of the IRS’s administrative actions involving EOs. The recommendation responds directly to a chief source of the public’s frustration with the agency—the inability to monitor its actions and have confidence that the laws are being implemented in an even-handed way.¹

Proposals to increase the transparency of government commonly confront some claimed governmental interest in secrecy, such as a national security concern. Transparency of the government’s tax decisions, however, encounters the further potential objection that it violates the privacy rights of taxpayers. This latter clash arises because the government’s tax administration decisions generally turn on the information it has extracted under compulsion from taxpayers. Thus, meaningful transparency of one (the government’s tax de-

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¹ This Essay assumes that the substantive EO tax law remains largely unchanged and continues to be administered by the IRS.
decisions) almost necessarily requires meaningful transparency of the other (taxpayer tax return information). The tax agency’s performance will always remain somewhat hidden and potentially suspect as long as the public has no access to the tax return information used by the agency to administer the law. In contrast, if the tax return confidentiality protections of EOs—provided to them and all other taxpayers by Section 6103 of the Internal Revenue Code—were relaxed, the IRS’s decisions affecting EOs could be opened to scrutiny. For example, the IRS could be required to create a public website detailing the progress of each EO application from initial submission to final determination. Other administrative actions involving an EO, such as an audit-related development, could be required to be disclosed in the same manner.

Thus, an essential element of the proposal in this Essay is greater publicity of EO tax return information. Disclosure of such information has been previously urged primarily to improve public knowledge and monitoring of EO activities and to protect the integrity of the electoral process. This Essay offers an additional rationale for increased publicity—to enable the public to know about (and monitor) the operations of its government. For EOs, the loss of confidentiality protections would be balanced by greater assurance that the tax agency is treating them fairly. Moreover, EOs and everyone else would benefit from heightened respect for the integrity of the agency and tax administration process. The following Sections describe the general conflict between tax return confidentiality and the public’s right to know; how and why the conflict can be overcome through increased publicity of EO tax return information and the IRS’s actions involving EOs; and the specific additional disclosures proposed.

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I. THE CONFLICT BETWEEN TAX RETURN CONFIDENTIALITY AND THE PUBLIC’S RIGHT TO KNOW

Although the first Civil War income tax laws generally gave the public access to income tax return information, Congress soon reversed its policy due to concerns about taxpayer privacy. Aside from three minor exceptions approved (and promptly repealed) in subsequent years, the public has never regained general access to the information.

In 1976, following abuses during the Nixon Administration, Congress also reduced government access to the information. Under Section 6103, Congress gave access only to tax administrators and others authorized by statute, and it prohibited them from disclosing the information any further. The 1976 and earlier changes thus made tax administrators’ access more exclusive, and restricted (or denied completely) the access of some of those with the greatest incentive to monitor possible improper use of the information. The changes increased the possibility of misuse of the information by tax administrators, or at least the suspicion of misuse.

Unfortunately, current law precludes the public from ever discovering whether its suspicions are justified. Section 6103’s prohibition on disclosure interferes with the IRS’s ability to respond to inquiries about its decisions. The agency’s reticence may be legitimate since violation of Section 6103 can result in severe penalties. But because improper disclosure is punished (whereas improper non-disclosure generally is not), there is an understandable inclination to interpret the prohibition expansively and avoid providing responses even when they might not be barred. Further, legitimate silence nevertheless increases the perception that the agency has something to hide.

Current law also makes the agency susceptible to unfounded charges. That problem arose during Congressional hearings in 1997

and 1998 when the IRS could not rebut taxpayer charges—later shown to be largely without merit—because Congress did not obtain waivers from the taxpayers to permit open discussion of their tax return information. Finally, when alleged agency wrongdoing is investigated, Section 6103 also prevents the investigators from clearly revealing their findings to the public.

In summary, unless taxpayers waive their rights, it is essentially not possible under current law for the public ever to obtain the full account of various controversies and to gain (or retain) confidence in the tax agency. This consequence of tax return confidentiality produces a dilemma, since it is commonly believed that confidentiality promotes confidence in the tax system by protecting the taxpayer’s reasonable expectation of privacy. It would seem, therefore, that either publicity or confidentiality of tax return information might undermine respect for the tax system. As explained in the next Section, one way out of this conundrum is to focus on the tax return information of EOs.

II. PUBLICITY OF EO TAX RETURN INFORMATION AND IRS DECISION-MAKING

Despite its general policy of confidentiality, Congress has long required publicity of a substantial amount of EO tax return information. There is required publicity of EO application materials (but only if and when the application is approved), EO annual information returns, and written IRS determinations issued to taxpayers including EOs (with identifying information generally redacted). This exception for EO information is very fortunate since it is specifically in the EO area that the IRS’s handling of tax matters has been repeatedly questioned. Notable disputes during the last fifty years include the IRS’s “ideological organizations” project during the Kennedy Administration; the activities of the “Special Service Staff” during the Nixon Administration; the Center on Corporate Responsibilities case, in which the D.C. District Court concluded the IRS had improperly denied the tax-exempt status of an organization for po-

8 See I.R.C. §§ 6104, 6110.
political reasons; the Church of Scientology dispute, in which the IRS's closing agreement with the Church was characterized by the Ninth Circuit in dicta as an "unconstitutional denominational preference"; the IRS's treatment of the Progress and Freedom Foundation and the Abraham Lincoln Opportunity Fund ("ALOF"), two EOs with ties to former Speaker of the House Newt Gingrich; the IRS's handling of the Christian Coalition's EO application; multiple allegations of politically motivated decision-making in the EO area during the Clinton and G. W. Bush administrations; and the current allegations of targeting of conservative political groups in the EO applications process. Because there is already publicity of a substantial amount of EO tax return information, slight liberalizations of current law might provide sufficient transparency to satisfy the public's right to know in the very area where the controversies have been the greatest.

Why is publicity of some EO information required under current law and publicity of even more information justified in the future? One reason concerns the special nature of EO tax law as well as the special function of EOs. Unlike issues such as the amount of a taxpayer's income, deductions, or credits—matters about which few persons other than the taxpayer (and parties already filing information returns regarding the taxpayer) would likely have much knowledge—EO tax law raises questions about the nature of an organization's activities (and whether they are consistent with its exempt purpose), the existence of private benefits obtained by persons involved with the organization, and the amount and type of political activity undertaken by the organization. The public might be expected to have useful information about those types of issues. Moreover, the public has an incentive to monitor the tax filings of

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10 See Sklar v. Comm'r, 549 F.3d 1252, 1265–66 (9th Cir. 2008); Sklar v. Comm'r, 282 F.3d 610, 618–19 (9th Cir. 2002).
11 The IRS retroactively revoked the tax-exempt status of ALOF but then reversed itself after the organization's appeal to an independent review process of the IRS (which the agency subsequently abolished later the same year).
12 Even after taking into account a period of justifiable delay, it took the IRS over a decade to process the organization's application, and the IRS has taken various steps to avoid judicial review of the merits of its position.
EOs—in contrast to the returns of individuals or for-profit companies—because many EOs benefit the public and depend upon public support. The publicity might, in turn, give an EO a strong incentive to be compliant in order to protect its public reputation. In short, the argument that publicity promotes better tax compliance may be particularly valid when it comes to EOs, and Congress has long recognized that distinction.

Another reason for the publicity requirement is that it helps to inform the public about EOs and permits monitoring of their governance practices (even if unrelated to specific tax law conditions). According to the Independent Sector (a trade group of EOs), disclosure is appropriate to assure contributors, volunteers, and other EO partners that the EO is acting in the public’s interest.14

There is also arguably a difference in the privacy expectations of EOs compared to all other taxpayers. In general, non-EO taxpayers provide their tax return information to the government under compulsion of law. In contrast, the information provided by EOs to the IRS is to some extent a matter of choice.15 An organization can obtain the same privacy protections as all other taxpayers by simply not claiming to be exempt. Under this view, the information an EO submits (and that becomes public) is roughly analogous to the tax information of taxpayers who seek judicial resolution of their tax disputes (which exposes their tax information to the public). Obtaining judicial review of tax disagreements is an important taxpayer right, but to protect the integrity of the tax system (and prevent the existence of secret law), Congress has placed a significant condition on the exercise of that right—publicity of the taxpayer’s return information and other materials pertaining to the court’s decision.16

Finally, the history of Section 6110—which requires publicity of written determinations issued by the IRS to taxpayers (including EOs)—reflects Congress’s concern about the development of secret law of the IRS.17 But the problem of secret law goes beyond the substantive positions the agency develops to interpret the law. It ap-

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14 See H. Comm. on Ways & Means, 106th Cong., Written Comments on Joint Committee on Taxation Disclosure Study 50 (Comm. Print 2000).
16 See I.R.C. §§ 6103(b)(4)(A), 7458, 7461(a).
plies equally well to the procedural steps actually undertaken by the agency to carry out the law. How the agency uses its limited resources to enforce the law may be at least as important as the interpretive positions the agency takes. Thus, publicity that allows procedural transparency should promote public confidence in the tax system in the same manner as substantive transparency. Procedural transparency would benefit all taxpayers, not just EOs. Given, however, the special problems the IRS has encountered in the EO area, it may be proper to focus on providing procedural transparency in that area.

III. PROPOSED EO AND IRS DISCLOSURES

A. EO application process

Under current law, application materials submitted by an organization to the IRS for recognition of its tax exemption are publicly available if and when recognition is granted. Third-party communications received by the IRS relating to an application are not covered by the publicity rule. In addition, information such as trade secrets, other privileged information, or confidential material for reasons of national defense may be shielded from the publicity.

The proposal advocated by this Essay would make application materials, third party communications related to the applications, and any follow-up submissions publicly available upon their submission to the IRS. The same exceptions for trade secrets, other privileged information, and confidential material would continue to apply.

Application materials are public under current law in order to allow the public to help enforce the tax laws. Members of the public familiar with an EO’s operations can assist in determining whether its activities are consistent with the representations in its application. But this help, for the most part, comes too late. Due to resource constraints, the IRS evaluates the eligibility of an organization for

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19 See I.R.C. § 6104(a)(1)(A); Treas. Reg. § 301.6104(a)-1(c) (2013).
21 See 2 Staff of Joint Comm. on Taxation, supra note 3, at 7, 86–88.
exemption when the organization first applies for recognition. Once the agency recognizes an organization’s exemption, it is rare for the IRS to reconsider the issue. Thus, public input at the earlier stage—when an application is still pending—would provide the most valuable help to the agency. This can occur only if the application materials are available to the public at the earlier point.

To be sure, when an application is still pending many organizations may have little or no track record of activities, and the public may, therefore, have little information about them. But in selected cases, the IRS looks beyond the four corners of an organization’s application materials to determine whether its representations are consistent with other available information about the organization. At least in those cases, public input might be useful.

Moreover, publicity of the application materials upon submission to the IRS would facilitate fuller disclosure of the IRS’s consideration of the application. If, for example, delays in processing an application or excessive information demands cause an organization to withdraw its application, there is no public record of it under current law (absent complaint from the organization). More generally, as illustrated by the current controversy, the procedure used by the agency to process EO applications is couched in secrecy. The proposal would require timely public disclosure of the agency’s administrative decisions involving an application. The IRS might be required, for example, to create a website detailing the progress of each EO application from initial submission to final determination. The IRS presently maintains, for internal use, a web-based system containing EO application case histories, and it may be possible to adapt this system to permit public access. Disclosure of third-party communications relating to an application would add to the overall transparency.

The proposal, however, would not require disclosure of the agency’s internal deliberations, including the details of formulae used by the agency to select applications for higher scrutiny. This amount of agency secrecy is necessary to protect the agency’s deliberative process and offset the superior knowledge taxpayers have about information potentially relevant to their tax responsibilities. Since en-

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forcement of the tax laws is to some extent a cat-and-mouse game, the agency’s ability to use its limited enforcement resources most efficiently must be preserved. The administrative decisions after applying the formulae, however, would have to be disclosed, so the IRS would have strong incentives to use only tax-based factors in its selection process.

One possible argument against the proposal is that it might result in disclosure of the return information of non-EOS.23 This outcome would occur if an application is withdrawn or the IRS refuses to recognize the applicant’s exemption. But this concern misconceives the reason for the different publicity of EO and non-EO tax return information. Publicity of EO information is required not because of the organization’s status as exempt, but because of the type of issues raised by EO tax law and the public’s potential interest in monitoring the applicant organization’s compliance with that law. To be exempt, an organization must meet the conditions of that law and, in general, provide a public benefit and/or have public supporters. Since the public may have information relating to the eligibility conditions (and an incentive to provide oversight), it is appropriate to allow publicity of application materials even if the application is ultimately withdrawn or denied.

There may also be concern that the proposal would further politicize the application process.24 With the new transparency, there might be a natural tendency for the public to fixate on the few “hard” (and debatable) decisions revealed by the IRS. But the controversial nature of the IRS’s EO decisions is a consequence of the substantive EO tax law and its impact on matters of fundamental importance, such as elections. Making the decisions in secret does not make them any less contentious; if anything, it may heighten the degree of controversy. Moreover, the public may already have knowledge of some of the hard (and debatable) cases as a result of disclosures by the organizations affected. Those disclosures, however, may not be complete in order to put the organization’s position

in the best light. Opening up the applications and the IRS’s decision-making process would tend to ensure greater fairness by the tax agency in processing the applications and promote fuller communication to help insulate the agency from unfounded criticism.

Under current law, not all organizations are required to file an application for recognition of their exemption, and the new publicity requirement might discourage them from doing so. This consequence would exacerbate existing administrative difficulties when organizations whose exemptions have not yet been recognized begin filing information returns as if they were exempt. The proposal, therefore, would require most EOs to file for recognition in order to be exempt. This step would help give the IRS more information about more EOs on a current basis.

B. Other IRS decisions involving EOs

Current law requires publicity of an EO’s information return. Except for private foundations and Section 527 organizations, an EO’s donor information is shielded from publicity. Current law also requires publicity of IRS written determinations issued to any taxpayer, including an EO, but with certain information (including taxpayer identifying information) redacted. The general confidentiality protection of Section 6103 applies to all other tax administrative actions involving an EO, such as audit-related developments and closing agreements.

The proposal would not change the publicity requirements relating to information returns, including the non-disclosure of most donor information. While there may be important election law reasons to increase disclosure of donor information, there are only very limited tax policy reasons, such as whether a Section 501(c)(3) organization qualifies as a public charity rather than a private founda-

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25 No application is required to qualify for exempt status under most provisions other than §§501(c)(3) and 527.
26 See Aprill, supra note 3, at 401–02; Tobin, supra note 3, at 433–34, 439–40. The proposal could continue current law’s exceptions for certain religious organizations and very small EOs. See I.R.C. § 508(c).
27 See I.R.C. §6104(b), (d).
28 See I.R.C. §6104(b), (d)(3)(A); id. § 527(j)(2)–(3).
29 See I.R.C. §6110(a)–(c).
tion.\textsuperscript{30} Since the purpose of the proposal in this Essay is to increase the transparency of the IRS’s decisions, there needs to be a sufficient tax reason to justify the publicity. Publicity of donor information also raises concerns about its impact on giving and the privacy interests of the donors.

The proposal would relax confidentiality protections with respect to other IRS administrative decisions involving an EO, such as audit-related developments, written determinations (with no redaction of taxpayer identifying information), and closing agreements,\textsuperscript{31} and would generally require their timely disclosure by the IRS. The precise form and extent of the IRS’s disclosures would need to be determined by Congress after consultation with all interested parties—the IRS, EOs, and watchdog groups, among others. In fiscal year 2013, for example, only about one-fourth of the extremely limited number of EO examinations appear to have involved issues regarding the exempt status of an organization. The balance concerned questions, such as the amount of an organization’s employment tax liability or unrelated business income tax, which may be of little public interest (or about which the public may have little knowledge). The purpose of the required IRS disclosures is to provide greater assurance that the agency is administering the law in an even-handed manner based solely on sound tax administration principles. The relaxation of EO confidentiality protections would also permit the IRS to respond to assertions of unfair treatment by the agency.

For the same reason discussed in connection with EO applications, disclosure would not be required of internal agency decision-making relating to how it utilizes its limited enforcement resources. Thus, the details of formulae developed by the IRS to identify specific returns to be audited would not have to be disclosed. The outcomes, however, after applying those formulae—that is, the identity of the audited EOs and the progress of the audits—would have to be disclosed. The IRS again would have strong incentive to apply only tax-based factors in making its administrative decisions.

One possible concern about this proposal is that the newly disclosed information will be confusing and potentially misleading to

\textsuperscript{31} See 2 Staff of Joint Comm. on Taxation, supra note 3, at 7, 83–86.
the public. Closing agreements, for example, are negotiated settlements in which the parties make concessions on disputed points to avoid the greater cost of litigation. In their initial stages, audits may include assertions by a revenue agent with little or no basis in fact or law. Because of resource constraints, the IRS may choose to audit only selected EOs while leaving other similarly situated ones alone. All of these outcomes, if disclosed, might conceivably result in an incorrect inference being drawn by the public about an EO or the IRS. Concern about that possibility might deter an EO from entering into a closing agreement, agreeing to an audit adjustment, or seeking out an IRS written determination, and might also change IRS administrative practice.

EO tax law is complicated, and it is reasonable to think that administrative actions based on that law may not be easily understood by the public. Taken to its logical conclusion, however, this objection would lead to no disclosures at all, with all administrative (as well as judicial) decisions being made entirely behind closed doors. A better balance is needed to promote public confidence in the tax agency and system. Each of the problems described could likely be addressed through additional disclosures by an EO (or the IRS) clarifying the nature of the administrative action to the public. More generally, an important consideration for Congress in determining the specific format of the required IRS disclosures would be the minimization of public confusion and misunderstanding. Ultimately, efforts such as these may simply be part of the necessary cost of successful self-governance if, as famed Progressive publisher S.S. McClure wrote over 100 years ago, the “vitality of a democracy” depends upon “popular knowledge of complex questions.”

Another possible concern is that disclosure will show how little enforcement activity is actually undertaken by the IRS. Some believe, for example, that compliance is promoted by the appearance of a very robust agency and would be reduced if this illusion were


33 See Doris Kearns Goodwin, The Bully Pulpit: Theodore Roosevelt, William Howard Taft, and the Golden Age of Journalism 449 (2013) (discussing S.S. McClure’s writings). Even if the specific information disclosed is difficult for the public to process, the mere fact of greater openness may help the tax agency’s public reputation.
shattered. But aggregate data on the scant amount of IRS EO enforcement activity is already publicly available. Moreover, some portion of that activity concerns compliance with various exemption conditions rather than the collection of tax revenue from EOs. To be sure, if conditions are not met and exempt status is lost, there might be some tax liability at issue. But that would be a second order concern—the principal objective is to make sure an EO continues to operate in the manner required by the law. Thus, if the proposal affects compliance in the manner suggested, it would likely mean increased disregard by EOs of one or more of the EO eligibility conditions (rather than a major loss to the fisc). The development would help force policymakers to confront how seriously they wish those conditions to be taken. This same explanation should also help to allay concerns that the required IRS disclosures may go too far in exposing the agency’s strategies and thereby undermine its EO enforcement ability.

Finally, some may be worried that the end result of these proposals (as well as those involving EO applications) would be to increase the amount of controversy for the IRS. Greater knowledge of how the agency operates may simply generate more and more complaints about its judgments, and the IRS’s limited resources would be stretched even thinner. But the purpose of these proposals is not to reduce the general level of IRS controversies, however desirable that may be. Confronting and resolving disputes about the meaning of law and its application to a set of facts would seem to be a major and necessary function of any tax collector. Rather, this Essay hopes to minimize a particular type of dispute: whether the IRS is “playing fair” with the tools at its disposal. The public’s respect for the tax agency and tax system depends upon receiving assurance that this very basic promise of government is being kept.

CONCLUSION

The current controversy involving the IRS’s administration of the EO tax laws is simply the latest in a long succession of similar questions spanning at least five decades. This Essay has proposed addressing the problem through increased transparency of the IRS’s administrative actions involving EOs. Opening up more decision-making to public scrutiny would tend to deter IRS misbehavior, reduce suspicions of such misconduct, and promote fuller communica-
tion both to establish any impropriety and avert false charges against the agency.

Some readers may view this Essay and its proposals as overly pessimistic. As one distinguished practitioner wrote in opposing an earlier proposal for greater publicity of EO tax information:

Most practitioners who represent exempt organizations on a daily basis believe that the IRS generally does a pretty good job of carrying out its responsibilities. Involving the general public in the regulation of exempt organizations, particularly with respect to exemption applications and audits, is unnecessary and undesirable.34

This comment reflects the more general concern that although increased transparency may succeed in deterring some harmful and even possibly corrupt acts, it also can be expected to reduce the number of laudable (though possibly controversial) decisions by well-meaning (but risk-averse) public servants who become somewhat intimidated by their increased visibility.35 From this practitioner’s perspective, we should just have faith in our “pretty good” tax agency and let it fulfill its responsibilities without interference from the public.

And yet, the well-intentioned decision-makers at the tax agency do not serve in a vacuum. Among other things, they must have adequate resources and public support and cooperation for their decisions to result in positive outcomes. As shown in this Essay, the law has isolated the IRS—even more than what would normally occur to a nation’s tax collector—and hamstrung the IRS’s ability to rebut criticisms and quash unfounded charges. Combined with the underlying assumption of this Essay—that the substantive EO tax laws (including the permissible political activities of EOs) remain essentially unchanged and continue to be administered by the IRS—there is a toxic mix that seems destined to produce continuing doubts about the performance and integrity of the agency in the public’s mind. A critical first step must be to break the long cycle of suspicions of IRS misconduct and stabilize the agency’s public reputation. Only then can the agency’s well-meaning decision-makers—both

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34 Faber, supra note 24, at 40.
within and outside of the IRS’s EO division—begin to achieve the success we all hope for.