

To The Honorable Members of the Senate Finance Committee:

I am writing in response to a March 11, 2015, news release announcing that the Senate Finance Committee is seeking suggestions for improving the Internal Revenue Code.

Section 6033(j) of the Internal Revenue Code has not achieved its stated goal, has harmed both the IRS and non-profits, and has muddied the waters for donors. Repealing IRC 6033(j) will help make the tax code simpler, fairer and more efficient.

Law and Background

IRC 6033(j) begins by requiring the IRS to revoke the tax exempt status of any non-profit that fails to file a required return or notice for three consecutive years. Paragraph two of the subsection requires such revoked organizations to file new exemption applications before reinstatement, while paragraph three limits the retroactivity of reinstatements.

Sections 6033(i) and (j) were added to the Internal Revenue Code as a result of concerns that existing filing requirement exemptions hindered IRS efforts to maintain reliable records about small exempt organizations. ⁽¹⁾ Nearly 600,000 ⁽²⁾ automatic revocations later, however, there is no evidence that the existence of 6033(j) has led to better IRS data about non-profit organizations of any size. ⁽³⁾

Harm to the IRS

The automatic revocations mandated by section 6033(j) have sidetracked significant IRS resources. This drain began with efforts to publicize the change in law, and continues to this day as IRS employees carry out the paperwork involved in revocations and as they review reinstatement applications submitted by revoked organizations. ⁽⁴⁾ All this has taken place at a time when IRS Exempt Organizations resources are scarce and getting scarcer. Automatic revocations played a large part in transforming a backlog in processing exemption applications into a full-blown crisis, leaving some applicants waiting for years. In a late 2013 appearance before Congress, the Commissioner of the IRS revealed that the backlog of unassigned exemption applications had reached 65,000 - more than the IRS normally processes in a whole year.

Measures taken to deal with the backlog have made the IRS look capricious, backpedalling originally on due dates with a Voluntary Compliance Initiative, and later on guidelines and due dates for obtaining retroactive reinstatement. The 1023-EZ, an extremely simplified 501(c)(3) exemption application released in mid-2014, has allowed the IRS to make great strides with its application backlog, but has been widely criticized as going too far. ⁽⁵⁾

Beyond delays in processing, automatic revocations have done serious damage to the public's view of the tax agency. The very harsh penalty of revocation, imposed mostly on small charities that provide visible hands-on efforts in local communities, reinforces preconceived notions about IRS ruthlessness. At least ten thousand erroneous revocations, and the lack of any real avenue of appeal, have worsened the problem even further. ⁽⁶⁾

Harm to Non-profits

As reported by the National Taxpayer Advocate, most of the organizations revoked as a result of IRC 6033(j) were small public charities. ⁽⁷⁾ For nearly 100 years, small public charities did not have to file an annual return with the IRS. When, in 2006, a reasonable minimal annual filing requirement ⁽⁸⁾ was created, it carried with it an unreasonably severe consequence. Automatic Revocation, called "basically the death of the organization," by the Director of Exempt Organizations, ⁽⁹⁾ is a punishment that does not fit the crime.

Remember, 6033(j) was not enacted to deal with wrongdoing on the part of these small non-profits; there were NO allegations along those lines. Rather, the purported purpose was to help the IRS with its unreliable records, something almost wholly outside the control of these small non-profits. How can a "death penalty" be considered appropriate under these circumstances?

Section 6033(j) provides for revocation only after an organization fails to file for three consecutive years. It was apparently thought that three years would be enough time to "get the word out" about the new requirement so that small organizations could comply. Indeed, the IRS has congratulated itself repeatedly for the depth and breadth of its efforts along these lines - more than a million notices were mailed out!

The irony, of course, is that those million notices were sent to addresses derived from the seriously flawed IRS database of non-profits - that's right, the database that 6033(j) was supposed to help fix. The fact that nearly 600,000 tax exempt organizations have had their status revoked despite IRS publicity efforts seems ample evidence that that IRS efforts failed to reach a large number of organizations.

Even if most of those revoked organizations are defunct, it still appears that a great many active organizations at risk of revocation received no warning of the danger. 63,000 organizations have gone to the trouble and expense of applying for and receiving reinstatement. It seems unlikely these non-profits would have shirked a mere annual filing if they had known it was required.

The National Taxpayer Advocate discussed the hardships imposed on automatically revoked organizations at greater length in reports to Congress in 2011, 2012 and 2013. ^{(6), (7), and (10)}

As mentioned above, she particularly emphasized the hardships imposed by erroneous revocations and the lack of any appeal procedures with respect to automatic revocations.

Finally, common sense tells us that the cost and trouble of preparing a reinstatement application takes staff time and resources away from any non-profit's ability to carry out its mission, and thus, indirectly works hardship on the beneficiaries of these organizations.

Donor Confusion

Before automatic revocations, donors simply had to refer to the list of eligible donors on the IRS website. Although donors were not entitled to rely on this list if the IRS had published a notice of

revocation, there were very, very few of these to check. Now, there are hundreds of thousands of revocations to check, and the list of qualified recipients has major changes every month; a donation that would have been allowed last month might not still be allowed this month. And thousands of organizations get their status back each month. A donation that would have been disallowed last month might be allowed again this month.

Complicating matters even further, the new Form 1023-EZ, released by the IRS partly to relieve the backlog caused by automatic revocations, requires only a few "attestations," leaving donors wondering whether 501(c)(3) status is still the "seal of approval" it once was.

Simpler, Fairer, and More Efficient

Repealing IRC 6033(j) would make the Internal Revenue Code simpler by doing away with the uncertainty generated by the current revocation/reinstatement revolving door. Repealing 6033(j) would make the Code fairer by removing a Draconian⁽⁹⁾ penalty that, in many cases, was imposed without adequate warning, for what amounts to overlooked paperwork. Repealing 6033(j) would make the IRS more efficient by freeing up Exempt Organizations personnel and resources that would otherwise be needed to continue the automatic revocation program.

Proposed Legislation

In February of 2015, Senators Dan Coats (R-Ind.) and Ben Cardin (D-Md.) proposed legislation to require the IRS to notify nonprofit organizations in a timely manner before their tax-exempt status is automatically revoked, and to allow the IRS to retroactively reinstate tax-exempt status if notice was not received.

Unfortunately, this bill would do little more than impose additional paperwork on the already seriously overworked Exempt Organization's function of the IRS, without addressing the underlying unfairness and hardship involved in automatic revocations.

Alternative to Full Repeal

If the Committee feels that outright repeal of IRC 6033(j) goes too far, there is an alternative. The words "or notice" could be removed from IRS 6033(j)(1):

(1) In general

If an organization described in subsection (a)(1) ~~or (i)~~ fails to file an annual return ~~or notice~~ required under ~~either this~~ subsection for 3 consecutive years, such organization's status as an organization exempt from tax under section 501(a) shall be considered revoked on and after the date set by the Secretary for the filing of the third annual return or notice. The Secretary shall publish and maintain a list of any organization the status of which is so revoked.

Because the Form 990-N required of small organizations is considered a notice, rather than a return, making this change to the law would remove the threat of automatic revocation for the very smallest exempt organizations.

Conclusion

Repeal of IRC 6033(j) will, inevitably, raise a number of issues, and even create problems for the IRS. It is my belief that any issues and problems that arise will be more than offset by the benefits the tax agency, non-profits, and their donors and beneficiaries will gain by putting this punitive and ineffective (at least with respect to its stated purpose) provision of the law behind us.

**We have given this experiment in tough love a fair chance.
It is time to take Section 6033(j) off the books.**

Thank you for offering the public an opportunity to provide input on improving the Internal Revenue Code.

Sincerely yours,

Sandy Deja ⁽¹¹⁾

Author, Prepare Your Own 501(c)(3) Application

Notes:

(1) Reasons for the changes to IRC 6033 were given in Senate Report 109-336

<http://www.gpo.gov/fdsys/pkg/CRPT-109srpt336/html/CRPT-109srpt336.htm>: "Notification Requirement for Exempt Entities Not Currently Required to File an Annual Information Return."

(2) The Automatic Revocation list on irs.gov dated April 13, 2015 lists 595,368 entities.

(3) In fact, I can provide anecdotal evidence to the contrary. In early 2010, in an article which appeared in the Exempt Organization's Tax Journal, <http://eotaxjournal.com/> (subscription required), I noted the following inconsistencies in the Exempt Organizations Master File (the IRS database of non-profits that sections 6033(i) and 6033(j) were supposed to help the IRS maintain): "...churches with a 990, 990-N or 990-PF filing requirement, private foundations with a 990 or 990-N filing requirement, codes not described in the IRM or elsewhere on the IRS site..."

In April, 2015, nearly four years after the IRS began "cleansing" its non-profit database, I looked for these same errors in the IRS data files dated March 10, 2015. I limited my search to filing requirement and private foundation inconsistencies as I had in 2010, and I only analyzed the organizations in IRS Region 2, The Mid-Atlantic and Great Lakes Areas.

Although I did not make a note of actual numbers in 2010, I found that today 3% of organizations whose foundation code identified them as churches did not also have the church filing requirement code. 2% of organizations not even described in 501(c)(3) are shown with a 990-PF filing requirement. Only a handful of public charities are shown with a 990-PF filing requirement, but more than 150 private foundations are coded as not having to file Form 990-PF. One foundation status code, one filing requirement code, and three private foundation filing requirement codes were not documented in the

EO Master File documentation available on irs.gov. And the on-line documentation continues to refer to the 990-N filing threshold as \$25,000, even though it changed several years ago.

(4) In September of 2013, Acting IRS Commissioner Werfel revealed that more than 30% of the exemption applications received were from organizations seeking reinstatement.

(5) "I.R.S. Shortcut to Tax-Exempt Status Is Under Fire," by Patricia Cohen, New York Times, April 8, 2015. http://www.nytimes.com/2015/04/09/business/irs-shortcut-to-tax-exempt-status-is-under-fire.html?_r=0

(6) "Erroneous Revocations of Tax-Exempt Status Burden Taxpayers, Create Re-work for the IRS, and Violate Taxpayer Rights," National Taxpayer Advocate Special Report to Congress, June 30, 2013. <http://www.taxpayeradvocate.irs.gov/userfiles/file/fullreport/special-report.pdf>

(7) National Taxpayer Advocate 2011 Annual Report to Congress, http://www.irs.gov/pub/tas/irs_tas_arc_2011_vol_1.pdf

(8) I have no objection to the requirement to file Form 990-N that was created by IRC 6033(i). It is the penalty that I think should be repealed.

(9) "basically the death of the organization," is a quote from the Director of Exempt Organizations at the time, in a January 21 speech delivered to members of the EO Committee of the American Bar Association's Tax Section, who also called the penalty Draconian.

(10) National Taxpayer Advocate 2012 Annual Report to Congress, <http://www.taxpayeradvocate.irs.gov/2012-Annual-Report/downloads/Most-Serious-Problems-Tax-Exempt-Automatic-Revocation.pdf>

(11) About Sandy Deja:

I have specialized in exempt organization tax issues since 1974, including 12 years as an IRS Exempt Organizations Specialist (1974 to 1986). I have been in private practice since leaving the IRS, preparing and/or reviewing thousands of exemption applications. In 2002, I wrote a book meant to help lay people apply for tax exempt status. For the record, repeal of IRC 6033(j) is likely to negatively affect my income.