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Committee on Ways and Means
Hearing On the Internal Revenue Service's Audit Selection Process and Internal Controls Within
the Tax Exempt and Government Entities Division

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Chairman Roskam, Ranking Member Lewis, and Members of the Subcommittee, thank you for the opportunity to testify here today.

By way of background, I am an attorney with the law firm of Harmon, Curran, Spielberg & Eisenberg, LLP. We are a small firm that is primarily dedicated to representing nonprofit organizations.¹ While many of our clients are not politically active, and some are consciously non- or bi-partisan, the politically engaged groups we work with are predominantly progressive. What I want to talk about today is what I have seen in recent years of these groups' experience with IRS audits.

Overview -- IRS Audit Activity

Over the years, the Exempt Organizations division of the IRS has maintained the functions of education, guidance, compliance and enforcement. However, the emphasis and resources allocated to each of those functions varies. In my two decades of practice, I have seen that pendulum move back and forth several times.²

In the early years of this century, the IRS conducted a "Political Activity Compliance Initiative," to investigate allegations of section 501(c)(3) organizations apparently violating the prohibition on intervention in campaigns on behalf of or in opposition to candidates for public office to which those organizations are subject. This was a systematic attempt to provide a mechanism to handle reports of charities engaging in political campaign intervention on an expedited basis during an election year. In one form or another, this PACI program was in effect for the 2004, 2006, and 2008 federal election years. Reports were issued after each cycle.

¹ While I advise and represent many different clients, I am appearing today solely on my own behalf. Although some client organizations have given me permission to talk about their experiences with IRS audits, in presenting this testimony I am representing only myself.

² To be precise, I have seen the precedential guidance released dwindle to a barely perceptible trickle, but the balance between education and enforcement has shifted.

With the release of the FY 2011 work plan, review of allegations of political campaign intervention was moved “from project to process” and no further reports have been forthcoming. After this transition, there was very little evidence that nonprofits were being audited even for blatant violations of the campaign intervention prohibition. I regularly attend meetings of the ABA Tax Section, and specifically its Exempt Organizations Committee. At breakfast meetings of the Subcommittee on Politics and Lobbying Activities, we would regularly ask the attendees whether anyone was handling or had heard of any audits inquiring into improper political activity. From 2009 into mid-2012, no one reported any indications of such audits occurring. While this was not a scientific survey and cannot be taken as definitive proof, it would be surprising if there had been a substantial political activities audit program under way and none of the examinations had come to the attention of that group of lawyers who specialize in that particular area of tax law.

More recently, the Service has speeded up processing of exemption applications in order to clear a serious backlog. IRS officials have also publicly stated that they plan to devote resources to following up after the exemption determinations are issued to ensure organizations are complying with the constraints imposed by the kind of tax exemption they enjoy. We have certainly seen that at my firm. My assessment indicates that we have handled more audits in the past five years than in the preceding fifteen. Our colleagues at the ABA meetings have reported a similar increase in audit activity, starting in late 2012 or early 2013.

Our Recent Audit Experiences

In the past few years we have seen at least nine audits of organizations that can reasonably be described as progressive. These have included both 501(c)(3) and 501(c)(4) groups. They have ranged from small to mid-sized, with budgets from less than \$100,000 to approximately \$3,000,000. The groups selected for audit have included those that lobby for or otherwise promote progressive policy changes, some that affirmatively advocate for progressive political candidates, some that support civic engagement at the grassroots level, and others that conduct data-intensive research on technical policy issues. Some audits have grown out of complaints from ideological opponents, some we were told have been just selected randomly, and in at least one case we suspect the audit was triggered by specific information in the Form 990 that was filed.

Even for the most well-run organization that is confident of its fundamental tax compliance, an IRS audit is disruptive and alarming. It draws time and energy away from working on the mission. Audits are inherently intrusive and usually expensive. In contrast to audits of individuals or for-profit businesses, an examination of a tax-exempt organization can be especially intrusive. The auditor needs to look not only at whether taxes (such as payroll taxes or unrelated business income tax) have been paid as required, but whether the entity still qualifies for tax-exemption. This entails an in-depth examination of activities to verify that the

organization's operations further the purposes for which it was granted exemption. For a 501(c)(3) organization this means demonstrating that it does not engage in any political campaign intervention and does not exceed the limited amount of lobbying it is allowed to do; for a 501(c)(4) group it means demonstrating that it is primarily operated for qualifying social welfare purposes, and political campaign intervention and other activities do not outstrip those social welfare activities. Financial records are only a part of the picture.

Costs can vary widely. Our firm's clients tend to be small to mid-sized organizations that are very budget-conscious. We have a commitment as a firm to helping these groups receive legal representation that they might not otherwise be able to afford. Consequently we work hard to keep our rates as low as possible, and we try to be flexible in how we provide our advice, and depending on the situation and the organization our involvement in the audit process may be limited in order to keep costs down. However, even the most minimalist approach will generate thousands of dollars in legal and accounting fees, not to mention the costs of staff time devoted to the process. A more typical audit can easily run to tens of thousands of dollars -- and that's when the whole thing goes perfectly smoothly, with only one visit from the auditor, one set of document requests, and no major issues raised that must be addressed.

An audit is typically initiated by a letter accompanied by a list of documents that the auditor wants to see. These can run to many pages, with multiple requests per page. In addition to detailed financial information, requests we have seen include:

- Minutes of meetings of governing body, including committees from January 1, 2010 to present
- All correspondence files of the organization with the IRS
- Copies of pamphlets, brochures, magazines, newsletters, programs, membership application, and other literature printed
- Manual of Standard Operating Procedures
- Contracts, leases, agreements etc. (including contracts for services)
- List of project managers, projects worked on, and compensation paid
- List of consulting agreements entered into, name of consultant, compensation paid, and copies of the consultant's work product
- Conflict of Interest statement
- Provide information on travel reimbursement policy/procedures
- Provide information on all agreements and transactions the organization has had, either directly or indirectly with any substantial contributor, trustees, directors, officers, creators, key employees, or members of their families, or with any taxable organization with which any such person is affiliated.
- Copy of Grant applications submitted to charities/foundations in which you received funding

- Provide information on grant requirements
- Provide final financial accounting for the grant funds received
- Evaluation and summary of the results obtained from grant funds received

An auditor's first visit can last days and can stretch over several weeks. It is often followed by additional requests for information. Typically these focus on areas the auditor has determined are of particular interest (e.g., one client was asked for details about credit card use), but often they can be burdensome and expensive to comply with.

From beginning to end the process will take months, and can take years. Even when everything goes perfectly smoothly and the auditor does not identify issues or concerns, I seldom see an audit wrap up in much less than a year. Two years is not unheard of. It is common that an auditor requests that the taxpayer agree to extend the statute of limitations in order for them to complete their work. To be sure, the audit is not active for this entire period. Examiners typically have multiple cases open, and can be called away for other purposes such as training. However, for the organization, there is an open IRS audit hanging over their heads for what often seems an excruciatingly long time.

An Illustrative Example -- Project Vote

To illustrate how this process can play out, let me tell you the story of an audit of my client Project Vote. Project Vote is a national, nonpartisan, nonprofit organization founded on the belief that an organized, diverse electorate is the key to a better America. Its mission is to build an electorate that accurately represents the diversity of this nation's citizenry, and to ensure that every eligible citizen can register, vote, and cast a ballot that counts. Since 1994, Project Vote has worked to increase voter registration and participation among historically underrepresented citizens, and has emerged in recent years as a national leader in voting rights.

In 2012, the organization received notice that the IRS was going to audit it for the year 2010. We learned that the basis for the audit was not random but that it was triggered by a complaint filed by a disgruntled former employee. One might expect such a complaint to be discounted when filed by a person with an obvious ax to grind, but in this case it was considered sufficient basis to open an exam.³

The initial audit letter was sent in April, 2012, and our first meeting with the examiner was held in June of that year. Although the audit was for FY 2010, in the process Project Vote was asked to extend the statute of limitations for 2008 while the examiner decided whether or not to open an audit of that year as well. Upon consideration the organization reluctantly agreed, judging it better to allow the auditor the time to realize that such further inquiry would not be a good use of

³ The employee was fired for dishonest conduct –use of a credit card for unauthorized personal expenses.

resources rather than having to make the decision under pressure of looming expiration of the statute of limitations.

The first set of document requests in this audit ran to six pages and generated over 1 GB of data, containing more than three thousand pages. This was followed in August, 2012 by another request for eight different types of information.

The audit was open for more than two years, and cost the organization over \$20,000 in legal and accounting fees, plus untold hours of staff time diverted to handle the matter. It eventually was closed in July, 2014 with a letter indicating that the organization's exempt status continued and it was not subject to any excise taxes or other tax liabilities.

Although Project Vote's activities are scrupulously nonpartisan, because it seeks to engage historically disenfranchised populations in our nation's civic life, it is perceived to be politically progressive. The fact that it, too, was subject to a lengthy, expensive, and intrusive IRS audit provides evidence that the agency is not targeting its audit resources on a politically biased basis.