



American Tax Policy Institute

The image shows two IRS tax forms for the year 2019. The top form is Form 990-PF, 'Return of Private Foundation or Section 4947(a)(1) Trust Treated as Private Foundation'. It includes instructions to not enter social security numbers and to go to www.irs.gov/Form990PF for instructions. The bottom form is Form 990-EZ, 'Return of Organization Exempt From Income Tax', labeled as a 'Short Form'. It also includes instructions to not enter social security numbers and to go to www.irs.gov/Form990EZ for instructions. Both forms are for the 2019 calendar year. A calculator is partially visible on the right side of the forms.

MISSION AT RISK? TAX EXEMPTION AND THE NEW SCRUTINY OF NONPROFITS

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Outline of Webinar

- **Ellen Aprill**, UCLA School Law and LMU Loyola Law School, *Possible bases for revocation*
- **Philip Hackney**, University of Pittsburgh School of Law, *Revocation procedures inside the IRS*
- **Megan L. Brackney**, Kostelanetz LLP, *IRC sec. 7428 (Declaratory judgment re revocation of exemption)*
- **Brandon DeBot**, Tax Law Center at NYU Law, *IRC secs. 7217 (Prohibition of executive branch influence on IRS investigations), 6103 (Confidentiality protections), and related IRC provisions*
- **Philip Hackney**, *Endowment tax*
- Questions



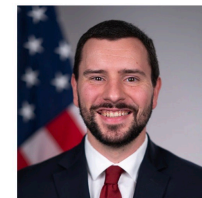
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Possible bases for revocation of exemption

- Violation of fundamental public policy per *Bob Jones*, 461 U.S, 574 (1983),
<https://supreme.justia.com/cases/federal/us/461/574/#tab-opinion-1955051>
- Substantial illegal purpose
- Not reviewing here standards for exemption of particular kinds of entities, such as educational organizations, environmental organizations, or hospitals.

Violation of fundamental public policy under *Bob Jones*

- The case found that official policies of Bob Jones and Goldsboro Christian School violated the fundamental public policy of discrimination in education.
- The *Bob Jones* decision left the criteria for fundamental public policy uncertain.
- It looked to longstanding practice of all 3 branches of government to conclude that a school discriminating against black students did not qualify for exemption.

Bob Jones con't

- In reaching its decision, the majority wrote that, since the 1954 Supreme Court decision of *Brown v. Board of Education*, “every pronouncement of this Court and myriad Acts of Congress and Executive Orders attest to a firm national policy to prohibit racial segregation and discrimination in public education.” 347 U.S. 483 (1954),
- The opinion also stated: “a declaration that a given institution is not ‘charitable’ should be made only where there can be no doubt that the activity involved is contrary to a fundamental public policy.”

Bob Jones con't

- Can an administration's new policy and Supreme Court's new interpretation of law meet this standard?
- Reliance on *Students for Fair Admissions v. President and Fellows of Harvard College*, 600 U.S. 181 (2023),
https://www.supremecourt.gov/opinions/22pdf/20-1199_hgdj.pdf
- Reliance on recent Executive Orders
- Public policy vs fundamental public policy
- Public policy -
 - All actions by government bodies to address societal issue
 - Can change as administrations change
- Fundamental public policy
 - Core values
- Reconsideration of case if it were to reach Supreme Court?

Another basis for potential revocation - DEI as a “substantial illegal purpose” - raises a number of issues

- Most authorities involve criminal activity. See, e.g., Rev. Rul. 75-384, *Church of Scientology v. CIR*, 83 T.C. 381 (1984).
 - From 1994 CPE text: The government “has an interest in not subsidizing criminal activity.”
- Activity vs purpose
- Substantial or not
- From CPE Text: “Substantiality must be considered *quantitatively* as well as *qualitatively*. The quantitative test focuses on the time and attention the organization gives to the illegal activity. . . . The qualitative test focuses on the seriousness of the illegality involved.”
- Cy pres – going to court to change a purpose that has become illegal - a last resort

Substantial illegal purpose con't

- Illegal or not for charity to pursue remedial discrimination
 - See Colinvau, The Legality of Charitable Remedial Discrimination, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5099785
- Reminder that exempt orgs must be nonpartisan only re campaign intervention
- As Justice Powell wrote, concurring in *Bob Jones v. United States*, “the provision of tax exemptions to nonprofit groups is one indispensable means of limiting the influence of governmental orthodoxy on important areas of community life.”

What Would the IRS Revoke?

- Upon formation of a charitable nonprofit corporation, organizations file a Form 1023 with the IRS to obtain a private letter ruling, called a “determination letter,” recognizing the organization as exempt from the income tax under IRC sec. 501(c)(3).
- IRC sec. 508 requires a charity file such a notice to be recognized.
- A positive ruling determines that the charity is “organized and operated exclusively” for charitable purposes.
- A revocation thus is of the determination letter issued upon initial application.

When Can the IRS Revoke a Letter Ruling?

- Rev. Proc. 2025-5, IRC sec. 12
 - (1) By a notice to the taxpayer to whom the determination letter was issued;
 - (2) By enactment of legislation or ratification of a tax treaty;
 - (3) By a decision of the Supreme Court of the United States;
 - (4) By the issuance of temporary or final regulations;
 - (5) By the issuance of a revenue ruling, revenue procedure, or other statement published in the Internal Revenue Bulletin; or
 - (6) Automatically, by operation of IRC sec. 6033(j), for failure to file a required annual return or notice for three consecutive years.

What Procedures are in Place?

- IRS conducts an examination (i.e., an audit) under IRC sec. 7602. The audit is of the Form 990 and the actions of the organization for each taxable year involved.
- Issue a Proposed Revocation Letter stating the basis for the revocation and alerting the organization to the right to protest/appeal the decision within 30 days of the proposed revocation in the IRS Office of Appeals; see 26 CFR IRC sec. 601.201.
- IRS Office of Appeals then issues a Final revocation if unsatisfied.
- IRC sec. 501(p) and terrorism?

History of Declaratory Judgment Actions

- Prior to *Bob Jones*, exempt orgs would have to pay tax assessed after exempt status revoked and then bring a refund claim in order to obtain judicial review.
- After that case highlighted this procedural barrier to judicial review, in 1976, Congress enacted IRC sec. 7428 in the Tax Reform Act.

Challenging a Revocation Determination

- If an agreement cannot be reached with IRS Appeals, the IRS will issue a final determination of revocation of exempt status.
 - **Organization must exhaust administrative remedies prior to filing suit.**
- At that point, the exempt status is revoked.
 - Under IRC sec. 7428, the organization has **90 days** from the date of the determination to file a declaratory judgment action challenging the revocation.

Challenging a Revocation Determination con't

- Three choices of forum:
 - U.S. District Court for District of Columbia (D.C. federal court)
 - U.S. Tax Court (D.C.-based with specialist tax judges)
 - U.S. Court of Federal Claims (D.C.-based and hears cases where government is defendant – federal contracting, patents, tax, etc.)
- Choice of forum requires an analysis of various factors including, but not limited to, individual facts and circumstances, precedent, and judges.
- An organization can further appeal the decision of any declaratory judgment.

Tax Court Rule 211(g)

The petition in an exempt organization action shall contain:

- 1)** The petitioner's name and principal place of business or principal office or agency;
- 2)** The date upon which the request for determination, if any, was mailed to the Internal Revenue Service, and the office to which it was mailed;
- 3)** A statement that the petitioner is an exempt organization or a private foundation or a private operating foundation, as the case may be, the qualification or classification of which is at issue;

Tax Court Rule 211(g) con't

- 4) A statement that the petitioner has exhausted its administrative remedies within the IRS;
- 5) Where the Commissioner has issued a determination—
 - A. the date of the notice of determination;
 - B. a copy of such notice of determination;
 - C. in a separate numbered paragraph, a clear and concise statement of each reason, in separate lettered subparagraphs, why the determination is erroneous; and
 - D. a statement of facts upon which petitioner relies to support each of such reasons.

Burden of Proof

- The exempt taxpayer bears the burden of proving that the Commissioner's determination in such situations is erroneous. Tax Court Rule 142(a); *Partners in Charity Inc. v. Comm'r*, 141 T.C. 151, 162 (2012).
- The exempt org must show both that it:
 - The org is entitled to the tax-exempt status;
 - The IRS's determination was incorrect.

Retroactive Revocations

Revocation of tax-exempt status or modification of a determination letter may be retroactive if—

- There has been a change in the applicable law;
- The organization omitted or misstated material information. A misstatement of material information includes an incorrect representation or attestation as to the organization's (1) organizational documents, (2) exempt purpose, (3) conduct of prohibited and restricted activities, or (4) eligibility to file Form 1023-EZ;
- The organization operated in a manner materially different from that originally represented in an application for recognition of exemption; or
- In the case of an organization to which IRC sec. 503 applies, the organization engaged in a prohibited transaction: (i) with the purpose of diverting corpus or income of the organization from its exempt purpose and (ii) such transaction involved a substantial part of the corpus or income of such organization.

Note: if a determination letter is revoked or modified by a letter with *retroactive* effect, the letter will (except in fraud cases) state the grounds on which the determination letter is being revoked or modified and explain the reasons why it is being revoked or modified retroactively.

Effective Date of Retroactive Revocations

- If the organization omitted or misstated material information in a request, revocation or modification will be effective **as of the effective date of the determination letter** issued in response to the request.
- If there is a material change in facts inconsistent with the conclusion of a determination letter, revocation or modification will ordinarily take effect **as of the date of such material change**.
- If a determination letter was issued in error or is no longer in accord with the IRS's position and IRC sec. 7805(b) relief is granted (dealing with retroactive regulations), ordinarily, the revocation or modification will be effective **not earlier than the date on which the IRS modifies or revokes the original determination letter**.

Impact of Revocation on Donors

- **Donors can continue to donate regardless of exempt status!** The question is whether the donation is deductible as a charitable contribution under IRC sec. 170.
- Under IRC sec. 7428(c)(1), if an exempt organization timely files a declaratory judgment action under IRC sec. 7428(b), then most **individuals** (excluding those responsible for the activities/failure to act that form the basis of the revocation) may claim contributions made during the period beginning on the date on which the notice of the revocation was published and ending on the date on which the court first determined in such proceeding that the organization was not exempt (under IRC sec. 170(c)(2)(A)).
- **Note**, however, that contributions of individuals may not exceed \$1,000 (and spouses are treated as one contributor).
- Contributors that are **exempt organizations** (under IRC sec. 170(c)(2)) may also take advantage of the contribution period set forth in IRC sec. 7428(c)(1), without a dollar limitation, but only if there is no pending revocation proceeding with respect to the contributing organization.

Protections Against Political Interference

- It is unlawful for the President, the Vice President, any employee of the Executive Office of the President or Vice President, or any Cabinet-level official other than the Attorney general to request, **directly or indirectly**, an audit or investigation of a particular taxpayer or interfere with any ongoing audit or investigation. IRC sec. 7217.
- Any prohibited request must be reported to the Treasury Inspector General for Tax Administration by the person who receives the request.
- Making a prohibited request or failing to report it are each punishable by up to five years imprisonment and/or a fine of up to \$5,000.

Protections Against Interference and Intimidation

- It is a crime to **corruptly, by force, or by threat of force** attempt to impede or obstruct the administration of the internal revenue laws. IRC sec. 7212(a).
- Violations are punishable by up to 3 years imprisonment and/or a fine of up to \$5,000 (or up to 1 year/\$3,000 if only by threats of force).

Confidentiality Protections

- IRC sec. 6103 provides a baseline rule that taxpayer returns and return information shall be confidential unless otherwise authorized by the statute.
- Protections extend to returns and return information held at agencies other than the IRS.
- Return information is defined broadly, covering “virtually any information collected by the IRS regarding a person’s tax liability.” *Landmark Legal Found. v. Commissioner*, 267 F.3d 1132, 1135 (D.C. Cir. 2001).
- Disclosure without statutory authorization is prohibited, defined broadly to include making taxpayer information “known to any person in any manner whatever.” IRC sec. 6103(b)(8).
- Inspection without statutory authorization is also prohibited, defined expansively to include “any examination of a return or return information.” IRC sec. 6103(b)(7); see IRC sec. 7213A.

Potential Consequences for Breaching Confidentiality Protections

- **Civil damages:** Cause of action to taxpayers whose return or return information is knowingly or negligently disclosed or inspected without statutory authorization. IRC sec. 7431.
 - Damages start at \$1,000 “for each act” of unauthorized inspection or disclosure; can be increased if actual damages are higher or for punitive damages for willful or grossly negligent conduct.
 - The U.S. is the defendant if the violator is a Federal officer or employee.
 - Statute of limitations is two years from the date the taxpayer discovers the disclosure.
 - No liability if violation results from a good faith, but erroneous, interpretation of IRC sec. 6103.
- **Criminal penalties:**
 - **Willful unauthorized disclosure:** up to 5 years imprisonment and/or \$5,000 fine. IRC sec. 7213.
 - **Willful unauthorized inspection:** up to 1 year imprisonment and/or \$1,000 fine. IRC sec. 7213A.
 - Generally subject to a three-year statute of limitations.

University Endowment Tax

- In the 2017 Tax Act, Congress implemented an endowment tax on universities with a large endowment compared to the total number of students. In 2023, 53 universities were subject to the tax of 1.4% on net investment income. IRC sec. 4968
- 2025 Reconciliation bill released by House progressively increases that rate as compared to endowment per student
 - \$500,000 and \$750,000: 1.4% rate.
 - \$750,000 and \$1.25 million: 7% rate,
 - \$1.25 million and \$2 million: 14%.
 - Above \$2 million: 21%.

Other case referred to in webinar

Z Street v. Koskinen, 791 F.3d 24 (D.C. Cir. 2015),
<https://law.justia.com/cases/federal/appellate-courts/cadc/15-5010/15-5010-2015-06-19.html>



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