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IRS Donor Rule Has Disclosure Movement Down But Not Out

By **Susan Leahy and Matthew Shapanka** (September 24, 2019, 5:37 PM EDT)

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The Internal Revenue Service dealt a blow to the corporate political contribution disclosure movement earlier this month when it published a Federal Register notice to begin formal rulemaking to eliminate a donor reporting requirement for certain tax-exempt organizations.[1]

Although the IRS capitulated to a July 2019 federal court ruling invalidating the agency's attempt to implement the same policy change through Revenue Procedure 2018-38, the decision to follow the formal regulatory process puts substance before form and avoids a protracted legal battle over the status of the policy under the Administrative Procedure Act.

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The Internal Revenue Code requires tax-exempt organizations to file "an annual return, stating specifically the items of gross income, receipts, and disbursements, and other such information ... as the Secretary [of the Treasury] may by forms or regulations prescribe."[2]

Under current regulations, most tax-exempt organizations satisfy that statutory duty by "fil[ing] an annual information return" that includes "[t]he total of the contributions, gifts, grants, and similar amounts received ... and the names and addresses of all persons who contributed, bequeathed, or devised $5,000 or more."[3]

While the vast majority of exempt organizations file IRS Form 990, religious organizations and certain charitable organizations with gross receipts of less than $5,000 per year are generally exempt from the duty to file an annual return.[4]

For most of the past 50 years, the IRS has required that all exempt organizations report the names and addresses of certain donors on "Schedule B" of Form 990. Revenue Procedure 2018-38, however, represented a significant policy shift, by providing that tax-exempt organizations, other than 501(c)(3) charities, were no longer required to report donor names and addresses to the IRS on the annual information return, Form 990.

Although, except for 501(c)(3) private foundations and 527 political organizations, donor names and addresses listed on Schedule B are redacted by tax-exempt organizations and the IRS before releasing

Form 990 publicly, the new policy would not require organizations to report donor names and addresses in the first place — although they would still have to report itemized contributions that exceed $5,000, but without the names and addresses of the donors.

Because the tax code requires organizations to collect and maintain donor information and empowers the IRS to demand such information from the taxpayer in the event of an examination, the IRS argued that it was not necessary for tax-exempt organizations to undertake the burden of reporting donors on the annual return and subject them to the risk of inadvertent disclosure.

However, the new revenue procedure proved short-lived. Montana Gov. Steve Bullock, the Montana Department of Revenue and the state of New Jersey quickly filed suit to invalidate the policy, arguing in part that their respective tax collection agencies rely on the Schedule B filings to enforce their own tax laws. In July, the U.S. District Court for the District of Montana invalidated Revenue Procedure 2018-38 under the Administrative Procedure Act.[5]

The court found that the IRS policy was invalid because it changed the existing regulatory provisions for the required content of annual returns without following the proper APA rulemaking procedures. The court concluded that, by issuing Revenue Ruling 2018-38 to abolish the requirement to report donor names and addresses, the IRS "effectively amended" Section 1.6033-2(a)(ii)(f) of the Treasury regulations without adhering to notice-and-comment procedures required by the APA.

The IRS had argued that as a matter of administrative law, Revenue Procedure 2018-38 merely concerned a matter of agency practice or procedure and was therefore an "interpretive rule," subject to change without notice and comment.

The court rejected this argument, ruling that an interpretive rule must be "consistent with the regulation that it seeks to interpret." Here, the new policy actually conflicted with the regulation. Accordingly, the court found that the policy change was a "legislative rule" that would have the force of law, not an interpretive rule, and must therefore undergo the public notice-and-comment procedure.

The court made clear that the plaintiffs did not challenge "the substance of the IRS' decision or whether substantial-contributor information must be disclosed," but rather that the IRS failed to follow the required notice-and-comment procedure.

Nothing in the court's order prevented the IRS from eliminating the requirement that tax-exempts report their donors, only that the agency follow formal legal procedures to effectuate its policy goals rather than, as the court put it, "attempt to evade the time-consuming procedures of the APA." This month's Federal Register notice corrects the key procedural defect found by the court by initiating the formal rulemaking procedures that comply with the APA.

The IRS also released Notice 2019-47, which provides relief from penalties for organizations that filed the 2018 Form 990 on or prior to July 30 without reporting the names and addresses of their contributors on Schedule B.

Under the proposed regulations, tax-exempt organizations must continue to file Schedule B and itemize contributions over $5,000, but organizations other than Section 501(c)(3) charities and Section 527 political organizations, would not need to include the names and addresses of contributors. That information must be kept by the organization, so it is available in the event of an IRS request.

The notice states that “[t]he IRS does not need the names and addresses of substantial contributors to tax-exempt organizations not described in Section 501(c)(3) to be reported annually on Schedule B of Form 990 or Form 990-EZ in order to carry out the internal revenue laws,” and again points to "compliance costs" and the risk of “inadvertent disclosure” of donors who would otherwise not be named publicly as justifications for the policy change. The IRS noted that this change “will have no effect on information currently available to the public.”

Practically speaking, the new IRS policy helps to further shield tax-exempt organizations — including politically active 501(c)(4) social welfare organizations — from having to report their donors to the IRS but does not preclude states from trying to curb so-called “dark money” political contributions by adding disclosure provisions to state law.

For example, New York and California already require detailed disclosures from all 501(c)(4) organizations. Washington’s DISCLOSE Act requires certain nonprofit organizations that expect to make certain political contributions or expenditures of at least $25,000 to register as “incidental” political committees and disclose their top 10 donors whose contributions aggregate to $10,000 or more in a calendar year.

Montana also has a broad executive order that compels certain contractors and prospective contractors to publicly disclose all contributions to an “entity, regardless of the entity’s tax status, that pays for an electioneering communication, or that makes contributions, transfers, or expenditures to another entity that pays for electioneering communications.”

In the wake of the IRS rulemaking, we expect more states to take steps to fill the void and shore up donor reporting and disclosure requirements for politically active nonprofits.

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[1] https://www.irs.gov/newsroom/treasury-and-irs-issue-proposed-regulations-and-provide-relief-for-certain-tax-exempt-organizations.

[2] I.R.C. § 6033(a)(1).

[3] Treas. Reg. § 1.6033-2(a)(ii)(f).

[4] I.R.C. § 6033(a)(3); Treas. Reg. § 1.6033-2(a)(ii)(f), Treas. Reg. § 1.6033-2(a)(2)(i).

[5] See Bullock v. IRS, No. 4:18-cv-00103-BMM (D. Mont., July 30, 2018).