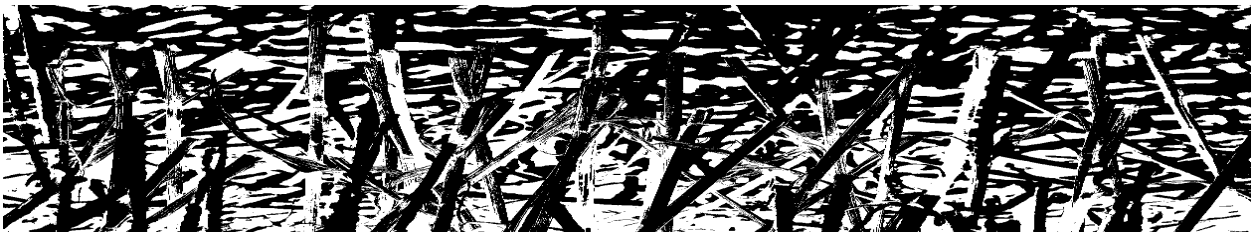

Jack Straw Fortnightly*

Soft targets

A few weeks ago, the Justice Department announced it had settled the last of five lawsuits arising from the so-called "targeting scandal" at IRS.[fn. 1] Apparently our long national nightmare is over, as Gerald Ford used to say. Almost. Or not.

The lawsuit in question, *Z Street v. Kautter*, was actually the first filed of the five, way back in August 2010, two and a half years before the "scandal" broke -- you remember, when Lois Lerner read off a prepared response to a planted question at a conference of tax lawyers, in a failed attempt to put the agency's spin on an investigative report that was to be released a few days later. Those were the days.

And *Z Street* was not typical of the other "targeting" cases. Most of those were "tea party" groups that had fairly obvious red flags on the question of political activity. Z Street presented itself as an advocate, yes, but primarily grassroots. It submitted a section 501(h) election with its application, committing to limit its lobbying expenditures to the section 4911(c) ceilings.

The determinations agent to whom the file was assigned sent a Letter 1312 requesting not much additional information, and the applicant promptly complied.[fn. 2]

This is when things got weird.

The agent was concerned that Z Street might be an "action organization" -- that is, as defined at reg. sec. 1.501(c)(3)-1(c)(3)(ii), an organization a "substantial part" of whose activities is "attempting to influence legislation by propaganda or otherwise." As distinct from "engaging in nonpartisan analysis, study, or research" and disseminating the results of that research.[fn. 3]

Not a problem for a (c)(4) org, incidentally. But Z Street wanted to solicit deductible contributions.

Occupied territory advocacy

So the specialist took the matter up with her manager. Rather than refer the file to EO Technical on the "action organization" question, the manager transferred the file to the "touch and go" group -- since disbanded in the wake of the "targeting scandal" --, which coordinated EO determinations cases that "may involve an abusive tax avoidance transaction, fraud,

terrorism, or," as arguably relevant here, "a risk of diversion of funds to support terrorism."

This was probably a mistake. [fn. 4]

The manager's theory, apparently, was that Z Street might send money to some other nonprofit that was helping to fund Israeli settlements in the "occupied" territories -- or as Z Street would prefer, the "disputed" territories. [fn. 5]

Just two weeks earlier, the New York Times had run a lengthy article on how the flow of money from American exempt orgs to these settlements, some of which are illegal under Israeli law, was undermining State Department efforts to broker a "two state" solution. The Washington Post had run an opinion piece on the subject a few months back.

In any event, the lawyer who was handling the application for Z Street started phoning the agent looking for a status update.

And she claimed that when she finally got through -- this was actually the day *before* the agent says she talked to her manager -- the agent said to her, in so many words, that the application implicated a "special concern" IRS had about organizations whose activities were "related to Israel" and that the file was to be forwarded to a "special unit" in Washington, DC to determine whether Z Street's activities "contradict the Administration's public policies" with respect to Israel.[fn. 6]

Diversionary tactics

Rather than wait for the 270-day clock to run out under section 7428(b)(2),[fn. 7] Z Street filed suit in federal district court in Pennsylvania -- not for a declaratory judgment on its (c)(3) status, but to determine that the alleged "Israel special policy" violated its First Amendment free speech rights, and to require IRS to process its application without reference to its political views. Also to require IRS to disclose the "origin, development, approval, substance[,] and application" of the alleged "special policy."

At the time, IRS had a stated policy to suspend processing of an application "if an issue involving the organization's exempt status . . . is pending in litigation."[fn. 8] So the filing of the lawsuit had the effect of putting Z Street's application on hold for another six years, while the parties engaged in procedural wrangling and not much discovery.

In October 2016, just a few weeks after the federal appeals court for the DC Circuit ruled in another of the "targeting" cases that the government could not secure dismissals of these lawsuits as moot until it actually processed the unresolved cases, IRS granted Z Street its requested (c)(3) status without asking any further questions. [fn. 9]

But Z Street insisted its complaint was not mooted by the granting of its application, because that was not what the lawsuit was about. It was about whether IRS in fact had an "Israel special policy,"

how that policy came to be implemented, and whether it violated Z Street's right to free speech. And to enjoin IRS from applying such a policy to its application.

The government again moved to dismiss, arguing that it no longer mattered why Z Street's application had been delayed, there was nothing left to enjoin. This argument did not directly address Z Street's contention that if IRS denied the "Israel special policy" existed, it could not assure the court the alleged abuse would not recur.

Cutting to the chase

Nonetheless, the parties ultimately settled, submitting a 15-page stipulation reciting Z Street's allegations and the government's denials, together with some general statements about how IRS "ought to" handle applications for exempt status. At paragraph 43, the government expressed its "sincere apology" for the "delay" in processing the application, but it attributed the delay almost entirely to the fact that it had suspended processing pending the litigation.

The stipulation concluded with a proposed "declaratory judgment" comprising two paragraphs. Paragraph 48 declared the truism that "it is wrong" to apply tax laws to an exempt org or an applicant for exempt status "based solely on lawful positions it espouses on any issues or its associations or perceived associations with a particular political movement, position, or viewpoint." Paragraph 49 clarified that paragraph 48 "does not constitute a finding" that IRS did anything wrong in the particular case.

The court set a hearing at which the parties were to explain "the legal authority, if any, that permits a court to issue a declaration that proclaims general principles of law without concomitant findings that apply that law to the facts of the particular case." Instead, the parties submitted a revised stipulation, deleting paragraphs 48 and 49.

The court approved the revised stipulation and dismissed Z Street's complaint with prejudice. So after nearly seven years and probably tens of thousands of dollars in lawyers' fees, the plaintiff settled for a nine-word "apology," with no admission from IRS -- to the contrary, a reiteration of its denial -- that the alleged "special policy" ever existed.

And of course no reassurance that their 990s will not be subject to "targeted" attention going forward.

Are we there yet?

Three of the other four "targeting" lawsuits were filed in the weeks immediately following the release of the TIGTA report in May 2013. Again, these had mostly to do with (c)(4) orgs -- but a few (c)(3)s as well -- connected in one way or another with the "tea party" movement.

In each case, the plaintiffs sought not only a declaratory judgment that IRS had violated their free speech and due process rights by selecting their applications for heightened scrutiny based on their

political views, but also monetary damages from the government and from individual IRS employees.

After much skirmishing over discovery and a couple of interlocutory appeals, two of these were resolved by consent judgments, *Linchpins of Liberty*, involving forty-odd orgs, last October and *True the Vote* in January.

The text of the stipulations in these two cases was nearly identical. Each included a paragraph numbered 40 in which IRS admitted that its handling of the plaintiffs' applications was "wrong" and expressed its "sincere apology." Each also included a paragraph 11 blaming former EO Director Lerner for failing to manage the situation or to report the problems to more senior staff.

The claims for monetary damages in each of these cases had been dismissed with prejudice, and those dismissals had been affirmed by the appeals court. So again, we are looking only at declaratory relief. And in these two cases, the trial judge let stand the parties' agreed language reciting that viewpoint discrimination in the abstract is "wrong."

Nothing to see here

The third case, *NorCal Tea Party Patriots*, is still pending in a federal district court in Ohio. Last October, the attorney general announced the case had been settled, but more than four months later the parties still have not submitted a text for the court to approve. Word on the street is there is actual money going to the plaintiff class on this one. Seven figures, to be divided among four hundred some odd orgs.

A few weeks before the parties agreed to settle, the government filed a motion for summary judgment that put Lois Lerner in a considerably better light than the stipulations for settlement in *Linchpin* and *True the Vote*. The copy made available to the public redacts references to deposition testimony of Ms. Lerner and/or her former deputy Holly Paz, but these apparently did not hurt the government's case.

Prior to giving those depositions, Ms. Lerner and Ms. Paz had moved the court to enter a protective order sealing their testimony. They argued that "the public dissemination of their deposition testimony would expose them and their families to harassment and threat of serious bodily injury or even death." And they had some history to back them up.

The court granted the motion in part, finding it was premature to seal transcripts of depositions that had not yet been taken, but allowing the parties[fn. 10] to designate the depositions "confidential: attorneys' eyes only," so that they could not be made a part of the public record without leave of court.

After the settlement was announced, Ms. Lerner and Ms. Paz moved to seal their depositions, arguing that because it would not be necessary for the court to consider their testimony in order to approve the settlement, these were not "judicial documents," to which the public would be presumed to have access.

The Cincinnati Enquirer moved to unseal the depositions and the unredacted versions of various motions and memos referring to the testimony. Both the Ohio state attorney general and Judicial Watch, a self-described "conservative" government watchdog, have filed papers supporting release of the sealed documents.

"A single regulatory challenge"

The fifth case, mentioned almost offhandedly in the DOJ press release, actually does involve what is apparently a "dark money" conduit for Republican candidates in western states.

Freedom Path was also filed as a "targeting" complaint, with the added wrinkle that someone at IRS had leaked a copy of the application to the investigative journalism site ProPublica. The government settled the wrongful disclosure claim for nominal statutory damages.

At the outset, the parties agreed to an order enjoining IRS from continuing to process the plaintiff's application for (c)(4) status pending litigation. The agency had already proposed to reject the application on the ground that the org was intervening in political campaigns. Although the complaint as initially filed named Lois Lerner as an individual co-defendant, the court dismissed the claims against her on the ground that she was not amenable to process in Texas.

Last July, the district court in Texas denied Freedom Path's motion for partial summary judgment on its claim that the "facts and circumstances" test set forth in Rev. Rul. 2004-6, by which IRS determines whether a (c)(4) advocacy org has made expenditures that are taxable under section 527(e)(2), is unconstitutionally vague. In November, the parties agreed to dismiss all the other claims in the lawsuit -- some with prejudice -- in order to allow the court to issue an appealable order rejecting that claim.

The plaintiff's opening brief to the 5th Circuit federal appeals court is due to be filed April 9.

You might remember that IRS did launch a regulatory project in November 2013 to bring clarity to the definition of the phrase "political campaign intervention" as used in section 501(c)(3) and the interpretive regs.

The proposed reg was met with an unprecedented avalanche of adverse public comment, much of it angry and ill-informed, cribbed from a handful of talking points provided by a few provocateurs. Though in fairness, the regulation as proposed was not carefully thought through.

Ultimately, IRS withdrew the proposed reg. The project was finally dropped from the agency's priority guidance plan in October 2017 -- just before John Koskinen's term as IRS Commissioner expired -- after several appropriations measures adopted by the Republican-controlled Congress included language forbidding IRS to spend any money resurrecting the project.

One of these measures, which was enacted into law in December 2015, requires an organization that

self-declares as exempt under section 501(c)(4) to alert IRS to the fact within sixty days of its inception or face a per diem penalty, and it allows an applicant for (c)(4) status who chooses instead to file a 1024 to avail itself of the declaratory judgment mechanism at section 7428.

The religious perspective

Last May, the President issued an executive order purportedly limiting enforcement of the "Johnson amendment," at least as it applies to religious organizations. The order directed the Treasury not to take "any adverse action," including "the delay or denial of tax-exempt status," against any religious organization for "speak[ing] about moral or political issues from a religious perspective, where speech of a similar character" -- and this is where the text of the order renders itself meaningless -- "has, consistent with law, not ordinarily been treated as participation or intervention in a political campaign," etc.

Of course, IRS has done essentially nothing over the years to enforce the Johnson amendment against religious organizations.

The House version of the recent tax overhaul would have limited the reach of the "Johnson amendment," allowing a (c)(3) org to engage in otherwise proscribed speech, if it was made "in the ordinary course" of the org's exempt activity and resulted in the org incurring "not more than de minimis incremental expenses." Because the Senate version did not include similar language, this provision was cut in conference as violative of the "Byrd rule," *i.e.*, it had no budgetary impact.

Notes, we got notes

[fn. 1]

Jack says each of these words should be separately bracketed by its own scare quotes. It is not a "scandal" unless someone actually did something discreditable. Unfounded allegations are not a "scandal." And it is not "targeting," in the sense that word has been used in this context, unless you are intentionally focusing on applicants representing a particular segment of the political spectrum while intentionally ignoring others outside that segment. The available evidence is susceptible to this reading only through the filter of a confirmation bias.

[fn. 2]

The lawyer who was handling this for the applicant mistakenly said she was responding to a "Letter 2382," which would have been a second request for additional information. This error was repeated in Z Street's pleadings to the district court.

[fn. 3]

In its amended complaint to the federal district court, Z Street asserted that "none of [its] purposes can be accomplished through legislative action." This is perhaps

disingenuous. In recent years there has been a push to enact state and federal legislation to counter the "boycott, disinvestment, and sanctions" movement, by for example requiring government contractors to disavow support for the movement. Z Street itself may not yet have been an active player in this campaign, but this may be because they have had almost no funding, pending this litigation. Folks want that tax deduction.

[fn. 4]

It is not obvious from the face of the application why the manager might have thought Z Street would be sending money overseas. Maybe one item among the materials submitted in response to the Letter 1312 could be construed as an indirect appeal for contributions to The Hebron Fund, which does provide direct support to Israeli settlers in the West Bank city, and has held (c)(3) exempt status since 1979. But even that would be a bit of a reach.

[fn. 5]

In the course of the litigation, Z Street argued that the use of the phrase "occupied territory advocacy" to describe three applications identified for possible referral to EO Technical in itself expressed a political view.

In September 2017, TIGTA issued a follow-up report, reviewing the ultimate disposition of 146 cases that had been processed while the "inappropriate" selection criteria were in use. That report did note a fourth application which it was unable to confirm was selected under the "occupied territory advocacy" criterion, but which fairly clearly is the Z Street application -- opened late December 2009, processing "suspended for many years due to ongoing litigation," approved after nearly seven years without referral to EO Technical.

The report found the that applicant in question had received "letters," plural, "reqesting additional information," including a request "for information that TIGTA had concluded" in its initial report, back in May 2013, was "unnecessary for processing political advocacy cases." If this summary does relate to the Z Street application, it is inaccurate.

The earlier TIGTA report listed exactly seven questions that had been included in some of the information request letters that that the EO function itself -- *i.e.*, not TIGTA -- had later identified as "unnecessary" to determining the exempt status of an advocacy organization. None of these appear in the Letter 1312 sent to Z Street.

[fn. 6]

Obviously the agent denied saying any of these things. It might be noted that Z Street did not submit an affidavit from the lawyer who claimed she did.

[fn. 7]

In Rev. Proc. 2014-40, IRS asserted that the interval between the date the Service requests additional information and the date

the applicant submits the requested information does not count toward the 270 days.

[fn. 8]

With slight modification, the policy remains in place today. It is entirely possible Z Street and its lawyers triggered this policy intentionally, calculating they could get more mileage out of the controversy over the alleged political intrigue than by simply seeking a declaratory judgment on the question of its (c)(3) status.

[fn. 9]

"From this," Z Street argued, "it necessarily follows" that IRS had enough information in hand before the file was diverted to "touch and go" in June 2010 that it could have issued a favorable determination back then.

Actually, it does not follow. In its effort to clean house after the "scandal" broke, IRS processed the backlog of (c)(3) applications using a prototype of what is now the short form 1023-EZ. In effect, they threw in the towel.

As Taxpayer Advocate Nina Olson has repeatedly pointed out, the "streamlined" application simply shifts the burden of enforcement from determinations to examinations.

[fn. 10]

For purposes of this order, "parties" included the deponents themselves, though the claims against them had been dismissed.

Jack says

These orgs were not pursuing the question of their exempt status as an end in itself. At least some of them are ideologues, trying to delegitimize the process. And they accomplished what they set out to do. The gears locked up, senior management fell on their swords, congressional committees conducted show trials, and the media reported he said, she said.

Scapegoating individuals is just collateral damage.

Lerner and her crew saw the wave coming after *Citizens United*, but they weren't able adequately to brace for it. Of course they talked about it among themselves, and of course they said out loud, we cannot afford to misstep here. This is what people who are responsible to manage this kind of problem do. If they didn't, you would be complaining they were incompetent.

Then, sure enough, the wave hits. A raft of new (c)(4)s that might or might not be fronts for dark money. At any other time these kinds of groups would just self-declare. The 1024 is not mandatory. But this way we can flood EO determinations.

IRS tried to centralize the response to minimize the possibility one or another frontline agent would go off the reservation. People made mistakes. But no one has credibly established a political agenda at management levels.

The question is, where do we go from here? Do we want the tax law to subsidize political actors? If not, what mechanisms can we put in place to prevent it, that will not be vulnerable on the one hand to abuse and on the other hand to demagoguery? And when can we expect a bipartisan consensus on this to emerge?