



PRESIDENT
Rob McKenna
Washington Attorney General

PRESIDENT-ELECT
Doug Gansler
Maryland Attorney General

VICE PRESIDENT
J.B. Van Hollen
Wisconsin Attorney General

IMMEDIATE PAST PRESIDENT
Roy Cooper
North Carolina Attorney General

EXECUTIVE DIRECTOR
James McPherson

October 28, 2011

The Honorable Max Baucus
Chairman
Committee on Finance
United States Senate

The Honorable Orrin Hatch
Ranking Member
Committee on Finance
United States Senate

via fax

Dear Chairman Baucus and Ranking Member Hatch:

Re: Pension Protection Act of 2006 Provisions Regarding Information

Sharing Between the Internal Revenue Service (IRS) and State Charity
Regulators (Attorneys General)

I. INTRODUCTION

We write to express our collective desire that Congress amend the provisions of sections 6103, 6104 and 7213 of the Internal Revenue Code (IRC). This request is intended to enhance the effectiveness of state charity regulators as well as the IRS by enabling state regulators to more freely use information shared by the IRS.

II. BACKGROUND INFORMATION

State attorneys general typically have both common law and statutory oversight responsibilities over the charitable assets administered in their respective states including, but not limited to, testamentary and inter vivos trusts and foundations, individual and corporate fiduciaries, unincorporated associations, nonprofit corporations and their professional fundraisers and fundraising consultants. See Ex. A. There is a continuum of common law and statutory authorities that provide state attorneys general with broad regulatory responsibilities over the charitable sector.¹ Indeed, the common law authority vesting state attorneys general with these oversight authorities dates back to the Statute of Charitable Uses in 1601, predating by centuries our own federal tax code. Similarly, secretaries of state and state charity officials in other agencies responsible for consumer protection, licensing, or securities oversight in their respective states are vested with statutory authority over the activities of charitable organizations and their professional fundraising consultants and solicitors.

2030 M Street, NW
Eighth Floor
Washington, DC 20036
Phone: (202) 326-6000
<http://www.naag.org/>

¹ See STATE ATTORNEYS GENERAL POWERS AND RESPONSIBILITIES (Emily Myers & Lynne Ross, eds., 2007).

Although the specific functions of the IRS and state charity officials are distinct, they share a number of important objectives. While the IRS accomplishes its mission through the enforcement of our federal tax laws and state attorneys general apply state trust, nonprofit corporation, consumer protection, and charitable solicitations laws, the goals of these state and federal regulatory schemes often intersect—both state and federal regulators have material concerns about ensuring against excess compensation, private inurement, waste, fraud, conflicts of interest and other abusive practices. Despite these shared interests, however, a variety of constraints discussed more fully below on the IRS’s ability to share “tax return information” with state charity officials frustrate the synergies that would otherwise enhance the effectiveness of the limited enforcement resources available at both the state and federal levels.

It is commonly known that the IRS audits or examines less than one-half of one percent of all charitable organizations exempt under section 501(c)(3) of the Internal Revenue Code. It is also widely accepted that the IRS suffers limited resources to police the sector, in which, according to the National Center for Charitable Statistics, there are 1,127,287 tax exempt 501(c)(3) charities and private foundations administering over \$2,495,197,897,281 in charitable assets. Although federal law requires such organizations to make their informational returns (IRS Forms 990, 990EZ or 990 PF) available for public inspection and to state charity officials upon request,² prior to the Pension Protection Act of 2006, the IRS was precluded from sharing any other tax return information with state charity officials, including any instances in which the IRS may have discovered or received information or complaints concerning violations of state law. Widespread public access to the income, expenses and governance information of the charitable sector already allows the public and state charity officials to be the “eyes and ears” of the IRS by reporting abuses. In truth, the 50 state attorneys general and other state charity officials are on the “front lines” in regulating charities and annually refer many significant cases of abusive practices to the IRS Exempt Organizations Division.

The National Association of State Charity Officials (“NASCO”), which is affiliated with the National Association of Attorneys General (“NAAG”), has long advocated liberalizing the provisions of IRC §§ 6103 and 6104 to allow the IRS to freely share what is considered protected “tax return information” relating to charitable organizations. Such information-sharing would allow state attorneys general and other state charity officials to pursue cases that the IRS may lack the resources or authority to undertake, including the diversion of charitable assets by organizations in their respective jurisdictions where charitable assets are required to be deployed for the benefit of the public-at-large. In June 2004, NASCO testified to this effect before the Senate Finance Committee. See <http://finance.senate.gov/imo/media/doc/062204mptest.pdf>

III. THE PENSION PROTECTION ACT OF 2006

The Pension Protection Act of 2006 (the “Act”)³ was intended to respond to the circumstances described above and allowed the IRS to unilaterally share tax return information with state charity officials and share other such information upon request. Regrettably, section 1224(b)(5) and (6) amended IRC §7213(a)(2) to make it a criminal offense for any state official to disclose

² Federal treasury regulations also require private foundations to provide their IRS Forms 990PF to state attorneys general in their state of domicile or registration.

³ Public Law No. 109-280 (Aug. 17, 2006).

information shared by the IRS under IRC §6104(c)(2). Despite the good faith efforts of the IRS Exempt Organizations Division to implement these amendments,⁴ what was intended to facilitate the rigorous oversight of the charitable sector by state charity officials has failed to achieve its intended purpose.

IV. EXPLANATION OF THE PROBLEM

As a result of the Act subjecting information sharing between the IRS and state charity officials to IRC §7213's criminal penalties, the IRS has had to subject state charity officials, including state attorneys general, to the same informational safeguards imposed on the tax and revenue agencies of the 50 states. A copy of the 106-page IRS Publication No. 1075 that describes the multitude of safeguard procedures to which state charity officials must adhere may be found at the following URL: <http://www.irs.gov/pub/irs-pdf/p1075.pdf>.

These procedures not only create the ethical and legal conflicts described below, they are simply unworkable given the limited resources of state charity officials and should not apply to information regarding the revenue, expenses and governance data of charitable organizations already required to publicly report their financial and operational data. The IRS's understandable safeguards for the protection of confidential federal income tax information should be inapplicable.⁵ These safe guards, for example, do not permit state charity officials to enter any shared data through a word processing program on any networked computer for inclusion in a civil complaint without complying with a myriad of security requirements that state charity officials do not have the resources to implement. Consequently, despite years of diligent efforts by state attorneys general to obtain information from the IRS, only three state Attorney General offices—New York, California and Hawaii—have entered into information-sharing agreements with the IRS since the adoption of the Act nearly five years ago.

Even the three states that have entered into information-sharing agreements have had to construct an uncomfortable “fiction” to use the data:

1. When the IRS makes a disclosure to the state charity office, an official reviews the data, logs the receipt of the information, and must place the data in a file secured by a least two barriers (doors, cabinets, etc).
2. In order to take investigatory or enforcement action, however, the state charity official must then rely upon an independent source, such as a telephone directory or advertisement, as the ostensible basis for contacting the subject charitable organization and requesting any recent communication to or from the IRS. Following this sort of procedure does not violate the safeguard provisions at issue because

⁴ State attorneys general acknowledge and commend the IRS's earnest efforts to administer these changes, educate state charity officials about the new requirements and make information sharing a reality. The IRS and state charity officials continue to enjoy an open dialogue about ways to improve charitable oversight. The comments expressed herein are in no way intended to criticize the IRS's implementation of the Act. The failure of this experiment is not the IRS's doing.

⁵ Other than on unrelated business income, charities are exempt from income tax under IRC § 501(c)(3).

information provided directly by the charitable organization is not subject to IRC §§ 6103, 6104 and 7213.

3. If asked, a state charity official is prohibited from disclosing that the inquiry was premised on the information received from the IRS and must hope that the organization voluntarily produces all relevant information and, if not, issue a subpoena for the information.

In addition to the above, the rules of discovery are generally very broad and require disclosure of the tax return information in many, if not most, state jurisdictions. Although discovery rules are only applicable whenever civil or criminal proceedings are instituted, the fact that such disclosure may be required warrants careful consideration about the propriety of states withholding section 6104 tax return information and/or the fact of an IRS referral. The requirement that states must withhold disclosure of section 6104 tax return information will be especially sensitive whenever that information has prompted the state's inquiry. Most well-represented defendants demand to know all of the details underlying a state's enforcement action and are quick to exploit any suggestion of selective prosecution or prejudice due to a lack of candor concerning the identity, timing, or source of a complaint or the basis for the commencement of the action. Although state attorneys general are permitted to disclose and utilize section 6104 tax return information in judicial and administrative proceedings, discovery often occurs well in advance of such proceedings and the prejudicial effect of withholding such information from defendants until the time of trial is likely to risk court-imposed sanctions prohibiting the use of the information. From a practical standpoint, the discovery process will also result in the disclosure of information to third parties beyond the state's control (witnesses, court reporters, etc.).

Moreover, the security requirements create problems even when the shared information is not used to pursue an investigation or enforcement action. Some states have record retention laws that govern the return or destruction of state records which are likely to conflict with the provisions of section 6103(p)(4). Many states have their own versions of the federal Freedom of Information Act (FOIA) which may be sufficiently broad in scope to encompass the shared section 6104 return information. To the extent that return information under section 6104 is included within the scope of such statutes, states may be obliged to produce the information when requested.

In light of all of the above, states receiving section 6104 tax return information that cannot be used more straightforwardly are confronted with both ethical and legal dilemmas.

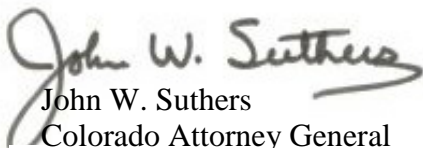
We see no reason why IRC notices of refusals to grant tax-exempt status, proposed revocations of exempt status, or proposed deficiency taxes for prohibited transactions under chapters 41 or 42, such as intermediate sanctions, taxes on self-dealing transactions and similar matters involving public charities and foundations, should be subject to the same criminal penalties and security procedures applicable to individual and corporate income tax return information. This is all extremely valuable and important information that allows state charity officials to fulfill their statutory mandate. The safeguard requirements have proven unsuccessful and unworkable,

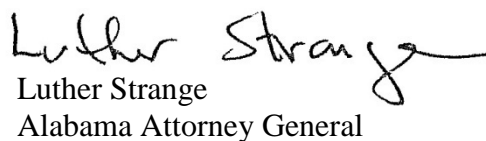
however, and even the three states that have attempted to “play by the rules” feel as if the information obtained directly from the affected charity is akin to fruit of a poison tree.⁶

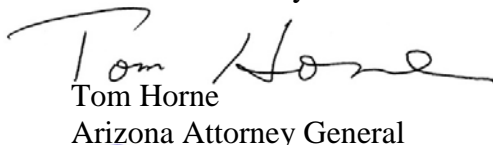
As officials that represent state revenue and taxation agencies, we fully appreciate the fundamental public policy reason for the protection of confidential taxpayer return information—to encourage taxpayers to freely and voluntarily report their income and pay their fair share of taxes. Similar considerations should not apply to organizations that are exempt from income tax, that operate with the public subsidy of tax-exempt status, and who must already publicly report their income, expenses, governance data, disqualified person transactions, excess benefit transactions, changes in exempt purpose and governing documents, embezzlements and losses of funds, etc.—information that is then publicly available online at <http://www2.guidestar.org>.

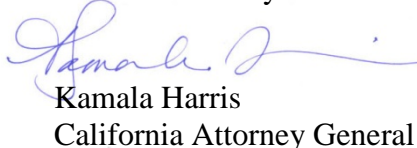
We urge Congress to remedy this situation by amending the federal laws to allow state attorneys general and other state charity officials to more freely obtain and use information possessed by the IRS to protect and promote the public interest we all share – that is, to ensure that charitable assets are lawfully administered at all levels of government.

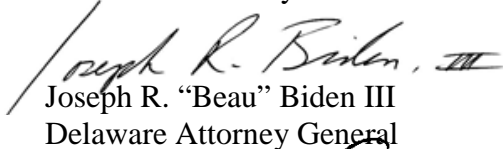
Sincerely,

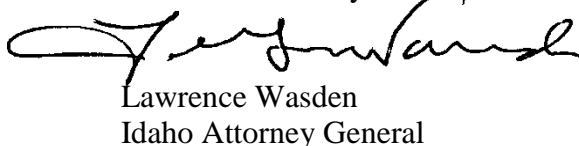

John W. Suthers
Colorado Attorney General

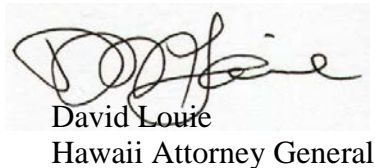

Luther Strange
Alabama Attorney General

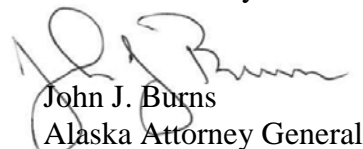

Tom Horne
Arizona Attorney General

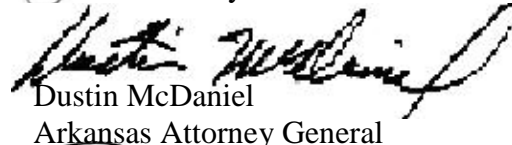

Kamala Harris
California Attorney General

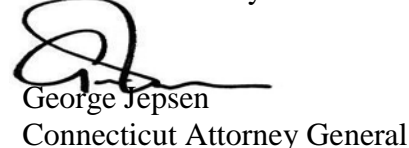

Joseph R. “Beau” Biden III
Delaware Attorney General



Lawrence Wasden
Idaho Attorney General


David Louie
Hawaii Attorney General


John J. Burns
Alaska Attorney General

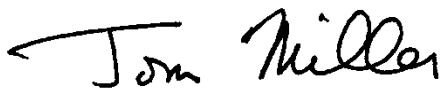

Dustin McDaniel
Arkansas Attorney General


George Jepsen
Connecticut Attorney General

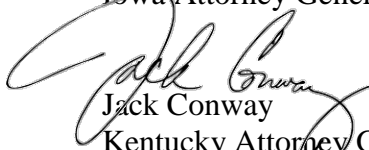

Lenny Rapadas
Guam Attorney General


Lisa Madigan
Illinois Attorney General

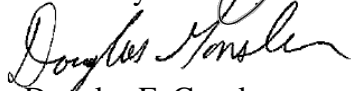
⁶ Recently proposed IRS regulations (IRS REG-140108-08) will not address any of the substantive issues presented.



Tom Miller
Iowa Attorney General



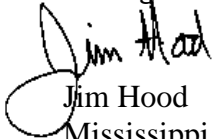
Jack Conway
Kentucky Attorney General



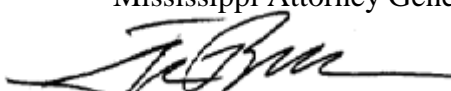
Douglas F. Gansler
Maryland Attorney General



Bill Schuette
Michigan Attorney General



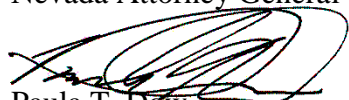
Jim Hood
Mississippi Attorney General



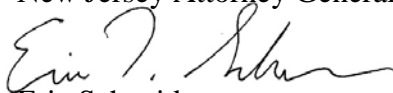
Steve Bullock
Montana Attorney General



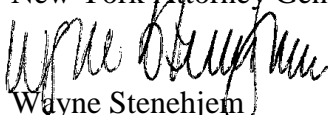
Catherine Cortez Masto
Nevada Attorney General



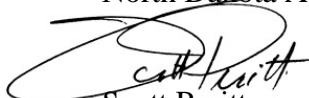
Paula T. Dow
New Jersey Attorney General



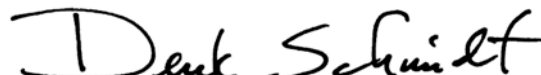
Eric Schneiderman
New York Attorney General



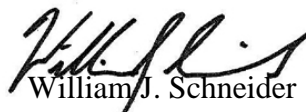
Wayne Stenehjem
North Dakota Attorney General



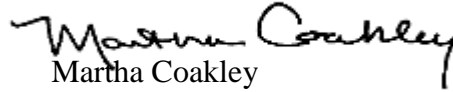
Scott Pruitt
Oklahoma Attorney General



Derek Schmidt
Kansas Attorney General



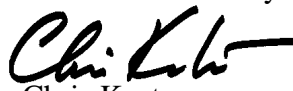
William J. Schneider
Maine Attorney General



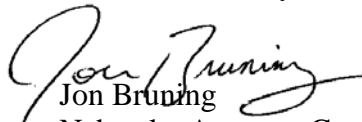
Martha Coakley
Massachusetts Attorney General



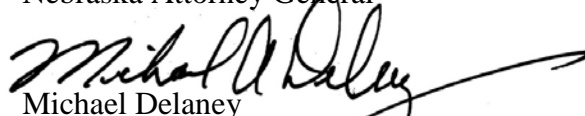
Lori Swanson
Minnesota Attorney General



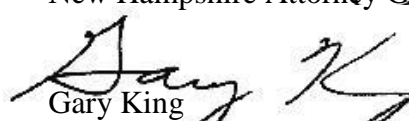
Chris Koster
Missouri Attorney General



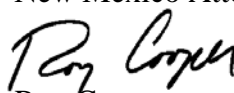
Jon Bruning
Nebraska Attorney General



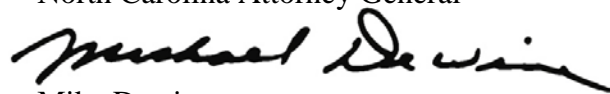
Michael Delaney
New Hampshire Attorney General



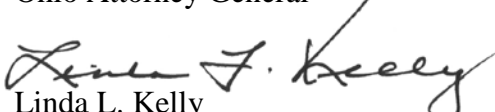
Gary King
New Mexico Attorney General



Roy Cooper
North Carolina Attorney General



Mike Dewine
Ohio Attorney General



Linda L. Kelly
Pennsylvania Attorney General

No Signature Available

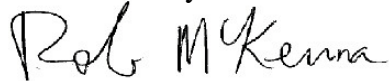
Guillermo Somoza-Colombani
Puerto Rico Attorney General



Marty J. Jackley
South Dakota Attorney General



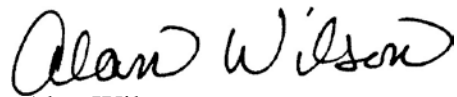
Mark Shurtleff
Utah Attorney General



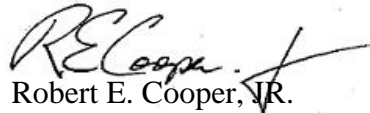
Rob McKenna
Washington Attorney General



Greg Phillips
Wyoming Attorney General



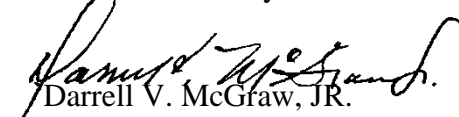
Alan Wilson
South Carolina Attorney General



Robert E. Cooper, JR.
Tennessee Attorney General



William H. Sorrell
Vermont Attorney General



Darrell V. McGraw, JR.
West Virginia Attorney General