IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
COLUMBUS DIVISION

THE BUCKEYE INSTITUTE,

Plaintiff,

v.

INTERNAL REVENUE SERVICE; DANIEL WERFEL, in his official capacity as Commissioner of Internal Revenue; UNITED STATES DEPARTMENT OF THE TREASURY; and JANET YELLEN, in her official capacity as Secretary of the Treasury,

Defendants.

No. 2:22-cv-4297-MHW-EPD

The Hon. Michael H. Watson, U.S.D.J.

The Hon. Elizabeth P. Deavers, U.S.M.J.

BRIEF FOR AMICUS CURIAE TAX LAW CENTER AT NYU LAW IN SUPPORT OF THE DEFENDANTS

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INTRODUCTION AND STATEMENT OF INTEREST

The Tax Law Center at NYU Law School is a nonpartisan, nonprofit center dedicated to improving the integrity of the federal tax system. Its staff includes tax-law experts with experience in tax policymaking, administration, and litigation. The Center aims to protect and preserve tax revenues, advance equity through the tax system, and improve tax administration. It submits this brief to offer its perspective on the implications of this case for the federal tax system.[1]

This case challenges the constitutionality of a federal statute that has existed for more than fifty years—the requirement that charitable organizations identify their major donors in their federal tax filings if they wish to receive the benefits of tax-exempt status under section 501(c)(3) of the Internal Revenue Code. The impetus for this half-century-late First Amendment challenge appears to be the U.S. Supreme Court's recent decision in *Americans for Prosperity Foundation v. Bonta*, 141 S. Ct. 2373 (2021), which struck down a California regulation requiring charities to disclose their major donors to register for business in the state. But the Court in *Bonta* went out of its way to note that the federal law challenged here is different in two key respects: It concerns the "conferral of tax-exempt status," whereas California's regulation had the potential to "prevent charities from operating in the State altogether." *Id.* at 2389. And it implicates Congress's "revenue collection efforts," whereas California's regulation was aimed at reducing charitable fraud. *Id.*

In its motion to dismiss (at 25–27), the government ably explains why a "condition of federal tax-exempt status" is analyzed differently than a compelled disclosure requirement. *Bonta*, 141 S. Ct. at 2389. Although the Supreme Court subjected the disclosure requirement in *Bonta* to "exacting scrutiny" under the First Amendment, *id.* at 2383, the Court has long held that a condition on the

[1] This brief does not purport to represent the views, if any, of New York University School of Law. No counsel for a party authored this brief in whole or in part, and no person made a monetary contribution intended to fund the preparation or submission of this brief. All parties consent to the filing of this amicus brief.

conferral of tax subsidies—including tax-exempt status and tax deductibility—is reviewed more deferentially, *see id.* at 2389 (citing *Regan v. Taxation with Representation of Wash.*, 461 U.S. 540, 545 (1983)). The statute at issue here is plainly constitutional under the standard applied in *Regan*, so this distinction is reason enough to grant the government's motion. Because the motion makes the point effectively, this brief does not expand upon the government's argument on this score. Nor does it address the government's alternative argument that the plaintiff lacks Article III standing.

Instead, this brief focuses on the other key distinguishing factor noted in *Bonta*: that this case involves "revenue collection efforts." 141 S. Ct. at 2389. Most major donors to 501(c)(3) organizations receive a large subsidy from the government in the form of a charitable deduction—the equivalent of up to 40.8 cents for every dollar donated by high-income individuals. Congress has chosen to provide this subsidy, which now costs over $70 billion a year, to encourage genuine contributions to charities. At the same time, Congress is aware that providing this subsidy creates the potential for illegitimate deductions, which costs the government money. For example, taxpayers could report deductions that exceed the amounts of their actual donations. Or they could claim deductions for transfers that were in fact purchases or loans, rather than donations. Or they could claim deductions for donations made to ineligible organizations. The list goes on. Protecting revenue collection by reducing such abuse is thus an important goal of Congress.

The statute at issue in this case directly advances that goal. By requiring tax-exempt 501(c)(3) organizations to identify to the IRS "all substantial contributors," 26 U.S.C. § 6033(b)(5), the statute ensures that these organizations and their major donors know that the IRS possesses this information. This knowledge provides a strong incentive for them to obey the law, reducing the likelihood of improperly claimed deductions. In this way, the statute addresses "the reality that some persons attempt to outwit the system, and [that] tax evaders are not readily identifiable," by encouraging voluntary tax compliance. *United States v. Bisceglia*, 420 U.S. 141, 145 (1975). Encouraging

voluntary compliance is especially important given the magnitude of the "tax gap"—the difference between the total taxes owed and the total collected—and the resource constraints that limit the number of enforcement actions the IRS may take. Yet the statute also aids enforcement by enabling the IRS to cross-check large claimed charitable deductions, thereby protecting the federal tax base.

In addition, the statute strengthens the rules for 501(c)(3) tax-exempt status in ways that further protect the tax base and the integrity of the tax system. When Congress enacted the substantial-contributor reporting requirement in 1969, it did so as part of a larger overhaul imposing new restrictions on tax-exempt charitable organizations. Many of these restrictions police the relationship between certain 501(c)(3) organizations and their substantial contributors, with Congress authorizing the imposition of taxes (and even the loss of tax-exempt status) if the restrictions are transgressed. *See, e.g.*, 26 U.S.C. §§ 507, 4941–4943. These restrictions build on other longstanding requirements for 501(c)(3) organizations, including that their earnings may not benefit any private shareholder, such as a substantial contributor. Requiring 501(c)(3) organizations to tell the IRS the identities of their substantial contributors, then, promotes compliance and "facilitate[s] meaningful enforcement of the limitations imposed by [Congress]." H.R. Rep. 91-413, at 36 (1969).

Taken together or apart, these reasons confirm what the Supreme Court itself indicated in *Bonta*: that the government's interest in tax collection supports the constitutionality of this statute.

ARGUMENT

I. Information reporting is critical to the federal government's revenue-collection efforts.

Our "tax structure is based on a system of self-reporting." *Bisceglia*, 420 U.S. at 145. "There is legal compulsion, to be sure, but basically the Government depends upon the good faith and integrity of each potential taxpayer to disclose honestly all information relevant to tax liability," and to pay the amounts owed. *Id.* That is by design. Under the system for revenue collection that

Congress created, the IRS does not audit every individual or entity's tax return. To the contrary, the IRS has the resources to audit only a small fraction of the returns filed each year. This means that the overwhelming majority of tax revenue that funds the federal government is collected through voluntary compliance—far outstripping the amount of revenue raised through IRS enforcement actions. *See* IRS, *Data Book 2022*, at 3, 59 (Mar. 2023), https://perma.cc/5VGD-U969; *see also* IRS, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2014-2016*, at 9 (Aug. 2022), https://perma.cc/MJ8J-UFPD.

To make this system of self-reporting work, Congress has long recognized that information-reporting requirements are essential. In 1917, when Congress expanded information reporting, the Senate Finance Committee explained why this was so important: because requiring "information at the source is a foundation upon which the administrative structure must be built if the income-tax law is to be rendered most effective." S. Rep. 65-103, at 20 (1917). A century's worth of experience has confirmed that insight. Congress has added dozens of information-reporting requirements to the tax code since 1917, *see* 26 U.S.C. §§ 6031–6060, and they are now "a linchpin of effective tax administration." Leandra Lederman & Joseph C. Dugan, *Information Matters in Tax Enforcement*, 2020 B.Y.U. L. Rev. 145, 151 (2020).

One reason why information reporting has become such a pillar of federal tax collection is because it promotes voluntary compliance. As the government points out in its motion to dismiss (at 20 n.8), it is now "widely understood as a matter of tax policy that disclosure to the IRS promotes lawful behavior." Former IRS Commissioner Charles Rettig recently observed that IRS "research shows that compliance is as low as 45 percent when income is subject to little or no information reporting or tax withholding," but "[w]hen there is substantial information reporting, compliance rises above 95 percent." Letter from Charles P. Rettig to Sen. Elizabeth Warren, at 23 (Aug. 27, 2021), https://perma.cc/P48Z-MNSV; *see also* Jay A. Soled, *Homage to Information Returns*, 27 Va. Tax

Rev. 371, 371–73 (2007) (describing research finding that, when the IRS does not have information necessary to police misconduct, "taxpayer compliance plummets"). A lack of information reporting is a significant driver of the tax gap, which totals about $500 billion or more annually. *See* IRS, *The Tax Gap*, https://perma.cc/D9G9-7NZP (last updated Oct. 28, 2022); Natasha Sarin, U.S. Dep't of Treasury, *The Case for a Robust Attack on the Tax Gap* (Sept. 7, 2021), https://perma.cc/RA6G-6X9W.

Information reporting is also critical to the government's ability to detect and address tax evasion and abuse. It gives the IRS information that it can use to predict noncompliance, and helps the IRS direct its limited audit resources and "enhance prospects for accurately targeting those likely to be noncompliant or particular noncompliant practices." Edward A. Morse, *Whistleblowers and Tax Enforcement: Using Inside Information to Close the "Tax Gap*," 24 Akron Tax J. 1, 3 (2009). And information reporting can improve the results of audits themselves, by providing information that can be used to verify or dispute the positions taken on returns and properly determine tax liability.

Information reporting by third parties—that is, a party besides the tax filer and the government—is particularly effective. It addresses the asymmetry between what the tax filer knows about the facts relevant to tax liability and what the government knows, and it "fosters taxpayer compliance because the taxpayer no longer acts unobserved." Lederman & Dugan, *Information Matters in Tax Enforcement*, 2020 B.Y.U. L. Rev. at 149–50. "The key to [its] effectiveness in increasing up-front 'voluntary' compliance is that it does not operate only after the fact, in the enforcement context," but also "decreases the perceived opportunity to evade tax." *Id.* at 162–63.

II. Congress enacted the substantial-contributor reporting requirement to help strengthen and enforce the rules governing tax-exempt organizations.

This case involves one of the many information-reporting requirements that Congress has added to the tax system over the past century. For more than 50 years, Congress has required tax-exempt charitable organizations to identify their major donors as part of the "Form 990" that they

file with the IRS each year. The requirement itself is older still: The information was required as part of the very first Form 990 in 1941, which was then a "simple two page form" filed by some tax-exempt organizations. Cheryl Chasin, Debra Kawecki, & David Jones, *Form 990 in IRS EO CPE text 2002*, at 1, https://perma.cc/TKT2-LUKR. Three decades later, in 1969, Congress codified this requirement as part of a larger effort to reform the rules for tax-exempt charitable organizations. *See* Pub. L. 91-172, § 101(d)(1), (2) (codified at 26 U.S.C. § 6033(b)(5)). Under current law, the term "substantial contributor" applies only to those who make large donations and are positioned to hold influence over the organization—namely, those whose donations (1) made up at least two percent of the total donations to the organization during the year, and (2) were at least $5,000 for the year. *See* 26 U.S.C. § 507(d)(2); 26 C.F.R. § 1.6033-2(a)(2)(iii)(A).

Congress imposed the substantial-contributor reporting requirement alongside a host of other reporting requirements, *see* Mot. to Dismiss 3, and did so for the express "purpose of carrying out the internal revenue laws." 26 U.S.C. § 6033(a). By the late 1960s, it had become increasingly clear that tax-exempt charities—and private foundations especially—were being used as vehicles for tax evasion and abuse, and that legislative action was necessary.[2] *See generally* Philip Hackney, *The 1969 Tax Reform Act & Charities: Fifty Years Later*, 17 Pitt. Tax Rev. 235 (2020). It had also become increasingly clear that this problem was compounded by a lack of accurate, pertinent information made available to the government. *See, e.g.*, James J. Fishman, *The Private Foundation Rules at Fifty: How Did We Get Them & Do They Meet Current Needs?*, 17 Pitt. Tax Rev. 247, 279 (2020) ("One aspect about the oversight deficiencies of private foundations that all agreed upon was the lack of accurate

[2] All 501(c)(3) organizations are either public charities or private foundations. Unlike public charities, private foundations generally receive their support from a relatively small number of donors. 26 U.S.C. § 509(a). The substantial-contributor reporting requirement applies to both public charities and private foundations, although private foundations file different paperwork with the IRS and are subject to additional disclosure rules. *See id.* § 6104.

information available to the government."). Congress sought to address these problems in two distinct yet complementary ways.

First, "Congress constricted the influence of the wealthy on private foundations and hindered the abuse of dollars put into charitable solution through income tax rules." Hackney, *The 1969 Tax Reform Act & Charities*, 17 Pitt. Tax Rev. at 235. It subjected these organizations to "various operating restrictions and to excise taxes for failure to comply with those restrictions." IRS, *EO Operational Requirements: Private Foundations & Public Charities*, https://perma.cc/K8BA-Z8WL.

Second, Congress bolstered the effectiveness of the new restrictions (and of other restrictions placed on tax-exempt charitable organizations) by broadening and strengthening information-reporting requirements. "The primary purpose of these requirements," as Congress's nonpartisan Joint Committee on Taxation put it, "was to provide the Internal Revenue Service with the information needed to enforce the tax laws." Joint Comm. on Internal Revenue Tax'n, *General Explanation of the Tax Reform Act of 1969*, JCS-16-70, at 52 (1970).

Congress had the same purpose in mind when it came to the substantial-contributor reporting requirement in particular. That provision was specifically "intended to facilitate meaningful enforcement of the limitations imposed by [the 1969 Act]." H.R. Rep. 91-413, at 36 (1969). And Congress expressly determined that it served the "purpose of carrying out the internal revenue laws," 26 U.S.C. § 6033(a)—that is, promoting tax compliance and collecting taxes.

III. The substantial-contributor reporting requirement directly advances the government's interest in revenue collection.

As discussed, "[o]ur self-reporting system of taxation relies on honesty at the front end and investigation at the back end." *Byers v. IRS*, 963 F.3d 548, 552 (6th Cir. 2020). The substantial-contributor reporting requirement serves both these purposes.

On the front end: The requirement serves the government's tax-collection interest by promoting voluntary compliance. It is well-established that there is a strong relationship between tax compliance and information-reporting requirements, as explained in Part I. *See also* Letter from Rettig to Sen. Warren, at 22 (Former IRS Commissioner: "[W]henever we implement new information reporting requirements, we see behavioral changes among taxpayers that result in higher voluntary compliance."). There is no reason to believe that the same wouldn't be true here.

Knowledge that the IRS possesses substantial-contributor information encourages the proper claiming of charitable deductions and compliance with the requirements of tax-exempt status. For the charitable deduction, reporting substantial-contributor information deters taxpayers from trying to claim a large tax benefit for which they do not in fact qualify. That is because the filer would know that the IRS will receive information from the charitable organization on major contributions, making it far easier for the IRS to verify whether a charitable deduction is properly claimed. And for 501(c)(3) organizations, the reporting requirement discourages them from violating the conditions that Congress has imposed on their tax-preferred status through improper transactions with their donors. That is because these organizations know that the IRS will have visibility into their major donors, which could shed light on potential violations of the conditions of tax-exempt status. To be sure, donors and 501(c)(3) organizations could work together to facilitate noncompliance, but it is common knowledge in tax administration that "collusion is riskier than cheating alone, and thus less likely." Lederman & Dugan, *Information Matters in Tax Enforcement*, 2020 B.Y.U. L. Rev. at 149.

Promoting voluntary compliance is, if anything, particularly important in this context. Charitable deductions have long been recognized as an area prone to abuse, and where such abuse

can be difficult to identify.[3] And these deductions add up to huge sums of money—reducing federal revenues by over $70 billion in 2022 for individual tax returns alone. U.S. Dep't of Treasury, *Tax Expenditures*, at 23, https://perma.cc/WT4P-K3M9. Charitable contributions are also deductible for corporate, estate, and gift tax purposes. 26 U.S.C. §§ 170, 2055, 2522. Even a small erosion in compliance would therefore translate to a big revenue loss. Likewise, there were over 1.4 million 501(c)(3) tax-exempt organizations as of 2021, with the IRS processing over 680,000 Forms 990 that year. IRS, *Data Book 2021*, at 23, 30 (May 2022), https://perma.cc/23JS-W78H; *see also* IRS, *SOI Tax Stats - Annual Extract of Tax-Exempt Organization Financial Data*, https://perma.cc/AD2P-YF57 (total from excel spreadsheet for exempt organization returns filed in 2021). Here, too, even a small reduction in voluntary compliance with the rules for tax-exempt entities could have a significant effect on tax-collection efforts. Especially given the magnitude of the tax gap and the IRS's resource constraints, promoting such voluntary compliance is a key plank of revenue collection.

On the back end: The substantial-contributor reporting requirement allows the IRS to better police limitations on 501(c)(3) tax-exempt status and prohibitions on self-dealing. And as already discussed, several other provisions impose excise taxes on organizations that run afoul of these limitations. Determining whether the limitations have been transgressed, and thus whether taxes are owed, can require knowing the identities of the organization's substantial contributors.

For starters, the reporting requirement helps the IRS determine whether an entity has violated the prohibition on self-dealing and private gain that is a fundamental requirement of tax-

[3] *See, e.g.*, Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 108th Congress*, JCS-5-05, at 462 (2005) (noting existence of "valuation abuses" for certain charitable deductions); Douglas M. Mancino, *Charities and Tax Shelters: Old Wine in New Bottles?*, Am. Bar Ass'n Tax Times (2004), https://perma.cc/K59D-RCGR (detailing why 501(c)(3) organizations "enjoy several tax benefits that make them particularly well suited to be targets for abuse by aggressive promoters of tax shelters"); Adam Looney, *Abuse of tax deductions for charitable donations of conservation lands are on the rise*, Brookings Institution (June 1, 2017), https://perma.cc/AE9A-ZF8D.

exempt status. Unlike a for-profit entity, a 501(c)(3) organization may not have any "part of [its] net earnings . . . inure[] to the benefit of any private shareholder or individual." 26 U.S.C. § 501(c)(3). For example, if an organization treats its contributors as shareholders (in other words, if it allows its earnings to inure to them), the organization is not entitled to an exemption from the 21% corporate tax, and the IRS must tax the organization on its activities. Substantial contributors are among those most at risk of receiving an improper benefit from the organization that could disqualify it from tax-exempt status. The reporting requirement thus promotes revenue collection by enabling the IRS to identify and address entity misclassification.

Additionally, Congress has imposed excise taxes on (1) excess benefit transactions between tax-exempt charitable organizations and their substantial contributors, 26 U.S.C. § 4958; (2) excess business holdings between substantial contributors and private foundations, *id.* §§ 4943, 4946; (3) self-dealing transactions between substantial contributors and private foundations, *id.* § 4941; and (4) distributions from donor advised funds to donors and related persons, *id.* § 4967. Congress has further provided for the loss of tax-exempt status and an accompanying excise tax for private foundations if the tax breaks received by substantial contributors and others are too large. *Id.* § 507. The substantial-contributor reporting requirement directly advances the enforcement of each of these provisions.

There is no ready alternative that would allow the IRS to easily obtain information about the identities of substantial donors, and therefore police these boundaries effectively. "Like officers and directors, substantial donors are classic suspects of those who might seek improper private benefits through their control of a nonprofit. But substantial donors, unlike officers and directors, are not public facing." Philip Hackney, *Dark Money Darker? IRS Shutters Collection of Donor Data*, 25 Fla. Tax Rev. 140, 140–41 (2021) (discussing changes to reporting requirements for noncharitable 501(c) organizations). And "[w]ithout substantial donor information, an IRS auditor has no reason

to begin to question certain transactions and operations of the nonprofit that accrue to the benefit of a substantial donor that could potentially lead to modification of a claimed tax result." *Id.*

The requirement to disclose substantial contributors may also help focus audit selection. The IRS's Tax Exempt and Government Entities Division has explained that it uses Form 990 information "to develop risk models to assess the likelihood of noncompliance by organizations, allowing more effective use of examination resources." IRS, *2011 Annual Report & 2012 Work Plan*, at 8, https://perma.cc/D2XF-DZTW. Specifically, the IRS uses data analytics to make decisions about which tax-exempt organizations to audit "based on quantitative criteria, which allows [the IRS] to allocate resources that focus on issues that have the greatest impact." IRS, Tax Exempt and Government Entities Division, *FY 2020: Program Letter*, at 5, https://perma.cc/DEZ6-HYYB. Among these issues, according to the IRS's tax-exempt compliance program, are "private benefit/inurement." *Id.* Put in pithier terms: The substantial-contributor reporting requirement serves "as a roadmap for audits." Hackney, *Dark Money Darker?*, 25 Fla. Tax Rev. at 140.

Nor is that all. When filers claim large charitable deductions to significantly reduce their tax burdens, substantial-contributor information can be used to cross-check the accuracy of those claimed deductions. If the IRS were stripped of its ability to obtain that information, it would be even more difficult for it to police those large charitable deductions on the back end, including for donations to private foundations—an area of particular congressional concern at the time the reporting requirement was enacted in 1969. *See generally* Fishman, *The Private Foundation Rules at Fifty*.

In short, the substantial-contributor reporting requirement is a reasonable means to an important end. A finding that the requirement is unconstitutional would directly undermine the federal tax base and would threaten the integrity of the tax system. The requirement is crucial to the federal government's revenue-collection efforts, and it should be upheld in its entirety.

CONCLUSION

This Court should grant the government's motion to dismiss.

Respectfully submitted,

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**pro hac vice application forthcoming*

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CERTIFICATE OF COMPLIANCE

I certify that this brief complies with the typeface requirements of this court's orders in this case because this brief was prepared using Microsoft Word in 12-point Baskerville, a proportionally spaced typeface in the body of the brief and 10-point typeface in the footnotes.

/s/ Jonathan E. Taylor
Jonathan E. Taylor

CERTIFICATE OF SERVICE

I hereby certify that on April 17, 2023, I electronically filed the foregoing with the Clerk of the Court for the United States District Court for the Southern District of Ohio by using the CM/ECF system. Participants in the case are registered CM/ECF users and service will be accomplished by the CM/ECF system.

/s/ C. Benjamin Cooper
C. Benjamin Cooper