



Statement for the Record, U.S. Senate Committee on Finance
Subcommittee on Taxation and IRS Oversight
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May 4, 2022

*Laws and Enforcement Governing the Political Activities of Tax
Exempt Entities*

Chairman Whitehouse, Ranking Member Thune, and members of the Subcommittee, thank you for convening this hearing and for your focus on the nonprofit sector. Independent Sector is a national membership organization founded in 1980 made up of nonprofits, foundations, and corporate giving programs nationwide. Working together, our approximately 500 member organizations and their networks reach every state and district and touch the life of every American in one or many ways. They range from some of the largest charities in the world to all-volunteer organizations, and from major philanthropic institutions to small foundations, academic centers, community-based organizations, and more. Independent Sector's core aim is to support these organizations and all civil society, working toward a healthy and equitable nonprofit sector to ensure all people living in the United States thrive.

Three Components of Effective Governance

Independent Sector has, from its beginnings, been committed to working with policymakers, sector leaders, and regulators to achieve a system of effective governance because we believe that is what is required to keep our sector healthy and delivering on its broad mission. As the title of today's hearing correctly notes, laws and enforcement are essential to proper oversight of the nonprofit sector. However, we hold strongly that a third component is equally essential for this system to function: committed self-regulation.

In 2004, Independent Sector worked in close partnership with Congress, and specifically the Senate Finance Committee's then-Chairman Grassley and then-Ranking Member Baucus, to convene the Panel on the Nonprofit Sector (the Panel). In 2005, the Panel delivered its recommendations to Congress, suggesting concrete actions that the Congress, the Internal Revenue Service, and sector organizations themselves should undertake to enhance sector

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oversight and governance. Many of those recommendations were enacted into law through the Pension Protection Act of 2006 and, in 2007, the Panel released *Principles for Good Governance and Ethical Practice* to help nonprofits self-regulate at even higher standards of public transparency and accountability than required by law.¹ These principles were later updated in 2015 and remain deeply relevant today, as evidenced by their ranking as one of the most accessed resources on the Independent Sector website.

Unclear Rules Provide the Worst of Both Worlds

According to the Internal Revenue Code, political activity is defined as directly or indirectly participating in, or intervening in, any political campaign on behalf of (or in opposition to) any candidate for elective public office. 501(c)(3) nonprofit organizations may perform limited lobbying, but are absolutely prohibited from participating in partisan political activity by the Johnson Amendment, a critical firewall that must be preserved for the integrity of both charities and our democratic system. 501(c)(4) nonprofit organizations are allowed to engage in unlimited lobbying and political activity within some parameters.

Unfortunately, there is widespread uncertainty in the nonprofit sector about what truly constitutes political activity. Nonprofit organizations need clearer, consistent definitions – like those proposed in the Bright Lines Project by a committee of nonpartisan nonprofit lawyers. Independent Sector is pleased to see some recognition of this problem, with bipartisan legislation recently introduced calling on the Government Accountability Office to consider opportunities to clarify what constitutes “political campaign intervention.”² Until then, unclear rules will provide the worst of both worlds: cautious good actors may remain on the sidelines, while bad actors operate in gray areas.

Most nonprofits, but particularly small community organizations, do not have dedicated policy staff with deep knowledge about nonpartisan advocacy rules during election years. When they are faced with uncertainty around whether an activity is allowed, they may not have the resources or connections to figure out the right path forward. Instead, they opt out of the policy process, silencing frontline experts often in charge of implementing critical services on behalf of government and the communities nonprofits represent. Amidst crises and uncertainty in 2020, Independent Sector heard from even large nonprofits with highly professional policy teams that were not speaking up about certain policy proposals that impacted their operations, because they did not want to enter a political activity gray area.

When nonprofits step aside from their appropriate role in nonpartisan civic engagement, they miss vital opportunities to advance their own missions, and American democracy suffers as well. According to a recent study, voters who were contacted by a nonprofit organization were 11% more likely to vote.³ This impact is even stronger for lower propensity voters.

On the other hand, the legal gray areas around nonprofit political activity embolden bad actors to exploit the hard-earned trust of nonprofits for private or partisan benefit. More specifically, private interests use nonprofits

¹ Accessible at independentsector.org/programs/principles-for-good-governance-and-ethical-practice/

² H.R. 7587, Nonprofit Sector Strength and Partnership Act, section 10

³ *Engaging New Voters*, Nonprofit Vote, 2021.

designated with special benefits, like donor privacy, to deceive the public and avoid regulation. As a result, the public could come to see more nonprofits as extensions of private or partisan agendas.

Trust: A Critical Nonprofit Asset

Public perception of nonprofit trustworthiness is the currency that drives the nonprofit sector. According to research conducted by Independent Sector in partnership with Edelman Intelligence, nonprofits are among the most trusted organizations in their communities, but they are not rated as highly as they were in 2020, despite increased visibility for the work they are doing.⁴

Trust plays a critical role in the extent individuals choose to donate, volunteer, or advocate with nonprofits. Individuals reporting low trust in nonprofits and philanthropy cite scandals, abuse, and perceived partisan motives as reasons for their skepticism. Conversely, individuals reporting high trust in the sector note their trust is built, in part, upon a faith that government regulations ensure nonprofits are serving their communities.

The IRS Has Inadequate Capacity

In addition to hurting the work of nonprofits, the lack of clarity in these rules also overburdens and compromises the IRS. The widespread use of private letter rulings by nonprofits in this area requires time-consuming analysis and response from IRS staff. As such, clearer rules could free up additional staff capacity to be directed toward the Service's core mission.

The need for this additional capacity is clear. From 2000-2013, the number of 501(c)(3) charitable organizations increased by more than 28 percent, while the number of full-time equivalent staff in the IRS Exempt Organizations Division (EO) increased by less than 6 percent. A 2020 Congressional Budget Office report⁵ found IRS appropriations had fallen by 20% in inflation-adjusted dollars since 2010, resulting in the elimination of 22% of its staff. The amount of funding allocated to oversight had declined by about 30% since 2010. The agency is struggling to keep pace with an exponentially growing and rapidly changing nonprofit sector. Independent Sector has been disappointed by this long-term decline in IRS appropriations and applauds the recently enacted increase for Fiscal Year 2022.

In addition to its direct impact on nonprofit sector oversight, inadequate IRS capacity has incentivized other shortcuts with damaging consequences. When the IRS created a streamlined Form 1023-EZ, nonprofit leaders expressed concern that such a simplified application approval process may open the door to incorrect determinations or increased abuse. Unfortunately, the IRS' own Taxpayer Advocate has repeatedly concurred, finding that more than one-third of ineligible 1023-EZ applicants were approved in recent years. Independent Sector believes that this error rate is simply unacceptable and we applaud recently introduced bipartisan legislation⁶ that would revoke form 1023-EZ and replace it after consultation with the nonprofit sector and other experts.

⁴ *Trust in Civil Society*, Independent Sector, July 2021. Also forthcoming research May 2022.

⁵ *Trends in the Internal Revenue Service's Funding and Enforcement*, CBO, July 2020.

⁶ H.R. 7587, Nonprofit Sector Strength and Partnership Act, section 9

Conclusion

Once again, thank you for convening this hearing and for focusing Congress' attention on the vital work of the nonprofit sector. Clear, objective rules for nonprofit political activity – balanced between laws, enforcement, and self-regulation – would allow more organizations to participate in their democracy and bolster public trust in the nonprofit sector. We appreciate your interest and look forward to working with you.